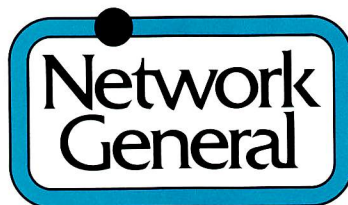


PROSPECTUS

1,900,000 Shares



Network General Corporation
Common Stock

Of the 1,900,000 shares of Common Stock, \$.01 par value, being offered, 1,068,000 shares are being sold by the Company and 832,000 shares are being sold by the Selling Stockholders. See "Principal and Selling Stockholders." The Company will not receive any part of the proceeds from the sale of securities by the Selling Stockholders. Prior to this offering, there has been no public market for the Common Stock of the Company. See "Underwriting" for a discussion of the factors considered in determining the initial public offering price.

See "Risk Factors" for information that should be considered by prospective investors.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public	Underwriting Discounts and Commissions(1)	Proceeds to Company(2)	Proceeds to Selling Stockholders
Per Share	\$8.00	\$0.56	\$7.44	\$7.44
Total(3)	\$15,200,000	\$1,064,000	\$7,945,920	\$6,190,080

- (1) See "Underwriting" for indemnification arrangements with the several Underwriters.
- (2) Before deducting expenses payable by the Company estimated at \$380,000.
- (3) The Company has granted to the Underwriters an option to purchase up to 285,000 shares of Common Stock solely to cover over-allotments. To the extent that such option is exercised, the Underwriters will offer such additional shares at the Price to Public shown above. If such option is exercised in full, the total Price to Public, Underwriting Discounts and Commissions and Proceeds to Company would be increased to \$17,480,000, \$1,223,600 and \$10,066,320, respectively. See "Underwriting."

The shares of Common Stock are offered by the several Underwriters named herein, subject to prior sale, when, as and if delivered to and accepted by them, and subject to the right of the Underwriters to reject any order in whole or in part. It is expected that delivery of the shares will be made at the offices of Alex. Brown & Sons Incorporated, Baltimore, Maryland, on or about February 9, 1989.

Alex. Brown & Sons
Incorporated

Hambrecht & Quist
Incorporated

The date of this Prospectus is February 2, 1989.

No dealer, salesman or other person has been authorized to give any information or to make any representation other than those contained in this Prospectus, and if given or made, such information or representation must not be relied upon as having been authorized by the Company, any Selling Stockholder or any of the Underwriters. This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy such securities in any jurisdiction to any person to whom it is unlawful to make such an offer or solicitation in such jurisdiction. Neither the delivery of this Prospectus nor any sale hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Company since the date hereof or that the information contained herein is correct as of any time subsequent to the date hereof.

Until February 27, 1989 (25 days after the commencement of the offering), all dealers effecting transactions in the Common Stock, whether or not participating in this distribution, may be required to deliver a Prospectus. This is in addition to the obligation of dealers to deliver a Prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

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The Company intends to distribute to its stockholders annual reports containing consolidated financial statements audited by an independent public accounting firm and quarterly reports for the first three quarters of each fiscal year containing unaudited consolidated financial information.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE COMMON STOCK OF THE COMPANY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

The following trademarks are mentioned in this Prospectus: Sniffer and TeleSniffer are trademarks of Network General Corporation; Ethernet is a trademark of Xerox Corporation; IBM is a registered trademark of International Business Machines Corporation; AT&T is a registered trademark of American Telephone & Telegraph Company; DECnet is a trademark of Digital Equipment Corporation; ARCNET is a registered trademark of Datapoint Corporation; 1-2-3 is a registered trademark of Lotus Development Corporation; dBase is a registered trademark of Ashton-Tate Corporation; VINES is a trademark of Banyan Systems, Inc.; AppleTalk is a registered trademark of Apple Computer Inc.; MS-Net is a trademark of Microsoft Corporation; NetWare is a registered trademark of Novell, Inc.; COMPAQ is a trademark of Compaq Computer Corporation.

PROSPECTUS SUMMARY

The following information is qualified in its entirety by the more detailed information and consolidated financial statements appearing elsewhere in this Prospectus.

The Company

Network General designs, manufactures, markets and supports software-based local area network ("LAN") analysis tools for a broad spectrum of physical connection technologies and communications protocols. The Company's family of products, marketed as "The Sniffer", enables customers to resolve LAN problems in a cost-effective manner. These products monitor the network, capture data packets for analysis and analyze protocols and network traffic. All of the Company's Sniffer products are based upon a common architecture and consist of the Company's proprietary software, one or more network connection cards and one of three PC/AT compatible hardware platforms.

Network General believes that its products are the only LAN analysis tools currently available for use across all the principal configurations of LAN physical connection technologies and protocols. While its major competitors offer products which support only Ethernet and StarLAN, Network General offers products supporting 4 Mbit Token-Ring, 16 Mbit Token-Ring, ARCNET and IBM PC Network Broadband in addition to Ethernet and StarLAN. The Company also offers detailed interpretation of a greater range of communications protocols than its competitors and believes it is the only vendor to offer automatic recognition and in-depth interpretation of protocols at all seven layers of the International Standards Organization ("ISO") communications model.

The Offering(1)

Common Stock offered by the Company	1,068,000 shares
Common Stock offered by the Selling Stockholders	832,000 shares
Common Stock to be outstanding after the offering	5,914,829 shares
Use of proceeds by the Company	Working capital and acquisition of capital equipment
NASDAQ symbol	NETG

Summary Financial Information

(in thousands, except per share data)

	Inception (May 15, 1986) to March 31, 1987	Year Ended March 31, 1988	Nine Months Ended December 31, 1987	1988
Summary of Operations Data:				
Revenues	\$ 556	\$4,911	\$3,194	\$8,854
Net income	—	\$ 832	\$ 532	\$1,779
Earnings per share	—	\$.21	\$.15	\$.37
Shares used in per share calculations	3,276	3,903	3,594	4,847

	March 31, 1988	Actual	December 31, 1988 As Adjusted (1) (2)
Balance Sheet Data:			
Working capital	\$2,663	\$4,145	\$11,711
Total assets	\$4,513	\$6,030	\$13,596
Long term obligations	\$ 75	\$ 84	\$ 84
Total stockholders' equity(3)	\$2,829	\$4,608	\$12,174

- (1) Assumes that the Underwriters' over-allotment option to purchase up to 285,000 additional shares of Common Stock from the Company is not exercised. See "Underwriting."
- (2) Adjusted to reflect the sale of the shares offered by the Company hereby and the anticipated application of the net proceeds therefrom.
- (3) Includes mandatorily redeemable Preferred Stock which will be automatically converted into Common Stock as of the closing of this offering.

All information in this Prospectus has been adjusted to reflect the 300-for-1 exchange of shares pursuant to the merger of the Company and its California predecessor effective December 3, 1987 and, except in the Consolidated Financial Statements, conversion of each outstanding share of Preferred Stock into one share of Common Stock, which will occur automatically as of the closing of this offering.

THE COMPANY

Network General designs, manufactures, markets and supports software-based LAN analysis tools for a broad spectrum of physical connection technologies and communications protocols. The Company's family of products, marketed as "The Sniffer", enables customers to resolve LAN problems in a cost-effective manner. These products monitor the network, capture data packets for analysis and analyze protocols and network traffic. All of the Company's Sniffer products are based upon a common architecture and consist of the Company's proprietary software, one or more network connection cards and one of three PC/AT compatible hardware platforms.

LANs have grown in size, complexity and importance as organizations have recognized the benefits of information sharing and distributed data processing through LAN technology. As LANs have become larger and more complex, they have become more likely to develop a wide variety of problems that are difficult to resolve. The prompt resolution of these problems has become critical due to the growing dependence of organizations on the proper functioning of the LAN. In the absence of effective LAN analysis tools, network managers, LAN software/hardware developers and field service personnel have typically attempted to resolve their LAN problems on a trial-and-error basis. This approach can be both time consuming and inefficient and can ultimately fail to isolate the problem. Network General's strategy is to supply network monitoring and analysis tools which enable customers utilizing most prominent LAN software and hardware configurations to resolve their LAN problems effectively.

Network General believes that its products are the only LAN analysis tools currently available for use across all the principal configurations of LAN physical connection technologies and protocols. While its major competitors offer products which support only Ethernet and StarLAN, Network General offers products supporting 4 Mbit Token-Ring, 16 Mbit Token-Ring, ARCNET and IBM PC Network Broadband in addition to Ethernet and StarLAN. The Company also offers detailed interpretation of a greater range of communications protocols than its competitors and believes it is the only vendor to offer automatic recognition and in-depth interpretation of protocols at all seven layers of the ISO model.

Customers can realize savings significantly greater than the purchase price of the Sniffer by:

- Improving the productivity of network users and support personnel
- Identifying and resolving network problems more quickly
- Reducing development expense and time-to-market for new products
- Enhancing the reliability of new network products
- Increasing the effectiveness of LAN field service personnel

Network General sells its products through domestic manufacturer's representatives, international distributors and selected OEMs. As of December 31, 1988, Network General had shipped over 500 Sniffer units to more than 300 customers. Purchasers include 37 of the Fortune 100 industrial companies and 40 of Datamation's top 100 data processing vendors, as well as many leading education, government and health care institutions.

The Company's founders developed the technology which serves as the basis for the Sniffer products while employed at Nestar Systems, Incorporated ("Nestar"), a company which they also co-founded. Pursuant to an agreement entered into between Nestar and the Company in May 1986, the Company acquired exclusive ownership of this technology, thereby allowing rapid introduction of the first version of the Sniffer.

The Company was incorporated in California in May 1986 and was reincorporated in Delaware in December 1987. Unless the context otherwise requires, "Network General" and the "Company" refer to Network General Corporation, a Delaware corporation, and its predecessors and subsidiaries. The Company's executive offices are located at 1945A Charleston Road, Mountain View, California 94043, and its telephone number at that location is (415) 965-1800.

RISK FACTORS

In addition to the other information in this Prospectus, the following should be considered in evaluating the Company and its business before purchasing the shares of Common Stock offered hereby:

Limited Operating History and New Market. The Company was organized in May 1986 and began shipping products in September 1986. The market for the Company's products is new, and purchasing patterns of potential customers have not yet become clear. Due to the Company's limited operating history and the limited history of the market for LAN analysis tools generally, there can be no assurance that the Company's revenue growth and profitability will continue on a quarterly or annual basis in the future. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business — Distribution, Marketing and Customers."

Competition. Competitive products are currently being shipped by Hewlett-Packard Company and Excelan, Inc., both of which have greater name recognition, more extensive engineering, manufacturing and marketing capabilities and substantially greater financial, technological and personnel resources than those available to the Company. The Company expects substantial additional competition from established and emerging computer, communications and test instrument companies. There can be no assurance that the Company will be able to compete successfully in the future with these existing or anticipated competitors, and the effects of such competition could be more adverse than would be the case if the Company had a broader product line. In particular, competitive pressures from existing or new competitors who offer lower prices or introduce new products could result in price reductions which would adversely affect the Company's operating margins. See "Business — Competition" and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Small Backlog and Potential Fluctuations in Quarterly Results. The Company operates with very little backlog, and a substantial majority of its revenues in each quarter results from orders booked in that quarter. The Company establishes its expenditure levels based on its expectations as to future revenues, and if revenue levels were below expectations this could cause expenses to be disproportionately high. As a result, a drop in near term demand could significantly affect both revenues and profits in any quarter. In the future, the Company's operating results may fluctuate for this reason or as a result of a number of other factors, including increased competition, variations in the mix of sales, announcements of new products by the Company or its competitors and capital spending patterns of the Company's customers. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

New Products and Technological Change. The market for the Company's products is characterized by rapidly changing technology and evolving industry standards. Accordingly, the Company believes that its future success will depend in part upon its ability to continue to develop and introduce products which support new or enhanced LAN connection technologies and communications protocols. In order to develop new products successfully, however, the Company is dependent upon timely access to information about new developments relating to such technology and standards. In the past, several vendors have assisted the Company by providing it with early access to new product information. There can be no assurance that such information will continue to be available or that the Company will be able to develop and market new products successfully and respond effectively to technological changes or new product announcements by others. The Company does not hold any patents and relies upon copyright, trademark and trade secrets laws to establish its proprietary rights in its products. See "Business — Distribution, Marketing and Customers", "— Product Development" and "— Proprietary Rights and Licenses."

Dependence Upon Suppliers. At present, all of the hardware platforms used in the Company's products are manufactured by two outside suppliers and all of the network connection cards used in the Company's products are manufactured by five outside suppliers. The Company's reliance on third party suppliers involves several risks, including limited control over quality and delivery schedules. In

the past, quality control problems on the hardware platforms supplied to the Company have caused delays in shipments of the Company's products. The Company does not currently have a long-term contract with its suppliers and acquires hardware through distributors on a purchase order basis. If the Company experiences significant quality control problems or supply shortages in the future, its revenues and profitability could be adversely affected. See "Business — Manufacturing and Suppliers."

Method of Distribution. The Company sells its products to end users in the United States through manufacturer's representatives and to international end users through international distributors. The Company's manufacturer's representatives and distributors also represent other lines of products which are complementary to those of the Company. While the Company attempts to encourage these representatives and distributors to focus on its products through marketing and support programs, there is a risk that manufacturer's representatives or distributors may give higher priority to products of other suppliers, reducing their efforts devoted to selling the Company's products. Although the Company believes that it is not dependent on any individual manufacturer's representative, international distributor or OEM, one manufacturer's representative organization accounted for 12% of the Company's total sales in the first nine months of fiscal 1989. See "Business — Distribution, Marketing and Customers."

Key Personnel. The success of the Company is dependent in part on its founders, Drs. Harry J. Saal and Leonard J. Shustek, and other key management and technical personnel, the loss of one or more of whom could adversely affect its business. In addition, the Company believes that its future success will depend in large part upon its continued ability to attract, retain and motivate highly skilled technical and management employees and consultants, who are in great demand. There can be no assurance that the Company will be able to do so. See "Business — Employees" and "Management."

Substantial Control by Officers and Directors. The Company's officers and directors will retain voting control of approximately 62% of the Company's Common Stock outstanding after the offering and therefore will be able to elect a majority of the Board of Directors and exercise substantial control over the Company's affairs. See "Management — Directors and Executive Officers" and "Principal and Selling Stockholders." Certain charter provisions relating to authorized but unissued Preferred Stock could have the effect of delaying, deferring or preventing a change in control of the Company. In addition, the Company's charter eliminates the personal monetary liability of its directors for breach of their duty of care, and the Company has entered into agreements with its officers and directors indemnifying them against losses they may incur in legal proceedings resulting from their service to the Company. See "Management — Limitation of Liability and Indemnification" and "Description of Capital Stock — Preferred Stock."

No Prior Market, Possible Volatility of Stock Price and Dilution. There has been no prior market for the Company's Common Stock, and there can be no assurance that a significant public market for the Company's Common Stock will develop or be sustained after the offering. The initial public offering price has been determined by negotiations among the Company, the Selling Stockholders and the Underwriters. Based on the recent trading histories of stock of other emerging companies, the Company believes factors such as announcements of new products by the Company or its competitors, sales of stock into the market by existing holders and quarterly fluctuations in financial results could cause the market price of the Common Stock to vary substantially. The stock market has recently experienced extreme price and volume fluctuations, which have particularly affected the market prices for many high technology companies and which often have been unrelated to the operating performance of such companies. This market volatility may adversely affect the market price of the Company's Common Stock. Also, investors participating in this offering will incur immediate, substantial dilution of book value. See "Dilution," "Shares Eligible for Future Sale" and "Underwriting."

USE OF PROCEEDS

The principal purposes of this offering are to increase the Company's working capital and equity base, to provide a public market for its Common Stock and to facilitate future access to the public capital markets. The net proceeds to be received by the Company from this offering are estimated to be \$7,565,920 (\$9,686,320 if the Underwriters' over-allotment option is exercised in full). The Company estimates it will spend approximately \$1,000,000 of the proceeds during the remainder of fiscal 1989 and 1990 on the acquisition of capital equipment (including certain computer and office equipment currently under lease from S&S Leasing Partnership, a company wholly owned by Drs. Saal and Shustek) and leasehold improvements. See "Certain Transactions — Other Transactions." The balance of the proceeds will be used for working capital requirements, primarily to finance accounts receivable and inventories. In addition, the Company may use a portion of the net proceeds to acquire businesses, products or technologies complementary to the Company's current business, although it has no such commitments and no such acquisitions are currently being negotiated or planned. Pending such uses, the net proceeds of this offering will be invested in short-term, interest-bearing investments.

The Company will not receive any of the proceeds from the sale of securities by the Selling Stockholders.

DIVIDEND POLICY

The Company has never declared or paid any cash dividends on its capital stock. The Company currently intends to retain any earnings for use in its business and therefore does not anticipate paying any cash dividends in the foreseeable future.

CAPITALIZATION

The following table sets forth the capitalization of the Company at December 31, 1988, and as adjusted to give effect to the sale of the shares of Common Stock offered by the Company (assuming no exercise of the Underwriters' over-allotment option):

	December 31, 1988	
	Actual (1)	As Adjusted
	(in thousands)	
Long-term obligations	\$ 84	\$ 84
Stockholders' equity:		
Preferred stock, par value \$.01 per share, 1,907,171 shares authorized, none outstanding	—	—
Common stock, par value \$.01 per share, 10,000,000 shares authorized, 4,846,829 shares outstanding, 5,914,829 shares outstanding as adjusted ...	48	59
Additional paid-in capital	1,973	9,528
Retained earnings	2,587	2,587
Total stockholders' equity	4,608	12,174
Total capitalization	<u>\$4,692</u>	<u>\$12,258</u>

- (1) Assumes the automatic conversion of each share of Preferred Stock into Common Stock as of the closing of this offering.

DILUTION

The net tangible book value of the Company as of December 31, 1988, was approximately \$4,602,000, or \$0.95 per share. "Net tangible book value" per share is equal to total tangible assets of the Company less total current liabilities and long-term customer deposits, divided by the number of shares of Common Stock outstanding after giving effect to the conversion of all outstanding shares of Preferred Stock into Common Stock. After giving effect to the sale of the 1,068,000 shares of Common Stock offered by the Company hereby, the pro forma net tangible book value of the Company as of December 31, 1988, would have been approximately \$12,168,000, or \$2.06 per share. This represents an immediate increase in net tangible book value of \$1.11 per share to existing stockholders and an immediate dilution of \$5.94 per share to new investors. The following table illustrates the dilution of a new investor's equity in a share of Common Stock as of December 31, 1988:

Initial public offering price per share	\$8.00
Net tangible book value per share as of December 31, 1988	\$.95
Increase per share attributable to new investors	<u>1.11</u>
Pro forma net tangible book value per share as of December 31, 1988, after offering.....	<u>2.06</u>
Dilution per share to new investors.....	<u>\$5.94</u>

The following table summarizes on a pro forma basis as of December 31, 1988, the difference between the existing stockholders and the new investors with respect to the number of shares purchased from the Company, the total cash consideration paid and the average price per share paid:

	Shares Purchased (1)		Total Cash Consideration (1)		Average Price Per Share
	Number	Percent	Amount	Percent	
Existing stockholders(2)	4,846,829	81.9%	\$ 2,029,307	19.2%	\$.42
New investors(2)	1,068,000	18.1%	8,544,000	80.8%	\$8.00
Total	<u>5,914,829</u>	<u>100.0%</u>	<u>\$10,573,307</u>	<u>100.0%</u>	

(1) Assumes that the Underwriters' over-allotment option is not exercised.

(2) Sales by the Selling Stockholders in this offering will cause the number of shares held by existing stockholders to be decreased, and the number of shares held by new investors to be increased, by 832,000 shares.

SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data set forth below with respect to the Company's consolidated statement of operations for the period from inception (May 15, 1986) to March 31, 1987, the year ended March 31, 1988, and the six months ended September 30, 1988, and the consolidated balance sheet data at March 31, 1987 and 1988 and at September 30, 1988, are derived from the audited Consolidated Financial Statements of the Company and should be read in conjunction with those statements, which are included in this Prospectus. The consolidated statement of operations data for the six months ended September 30, 1987, and the nine months ended December 31, 1987 and 1988, and the consolidated balance sheet data at September 30, 1987, and at December 31, 1987 and 1988, are unaudited, but in the opinion of management of the Company, reflect all adjustments (consisting only of normal, recurring adjustments) necessary for a fair presentation of results for interim periods. The operating results for interim periods are not necessarily indicative of results to be expected for the full fiscal year.

	Inception (May 15, 1986) to March 31, 1987	Year Ended March 31, 1988	Six Months Ended September 30,		Nine Months Ended December 31,	
			1987	1988	1987	1988
			(unaudited)		(unaudited)	
			(in thousands, except per share amounts)			
Consolidated Statement of Operations Data:						
Revenues	\$556	\$4,911	\$1,572	\$5,473	\$3,194	\$8,854
Cost of Revenues	160	1,129	347	1,163	730	2,038
Gross profit	396	3,782	1,225	4,310	2,464	6,816
Operating Expenses:						
Marketing and sales	66	1,302	354	1,676	784	2,709
Research and development	158	365	189	383	268	631
General and administrative	170	688	278	394	487	624
Total operating expenses	394	2,355	821	2,453	1,539	3,964
Income from operations	2	1,427	404	1,857	925	2,852
Interest Income (Expense), net	(2)	33	3	76	9	112
Income before provision for income taxes	—	1,460	407	1,933	934	2,964
Provision for Income Taxes	—	628	175	772	402	1,185
Net income	\$ —	\$ 832	\$ 232	\$ 1,161	\$ 532	\$ 1,779
Earnings Per Share	\$ —	\$.21	\$.06	\$.24	\$.15	\$.37
Weighted Average Shares Outstanding	3,276	3,903	3,579	4,847	3,594	4,847

Consolidated Balance Sheet Data:

	March 31,		September 30,		December 31,	
	1987	1988	1987	1988	1987	1988
			(unaudited)		(unaudited)	
Working capital	\$ (26)	\$2,663	\$ 223	\$3,788	\$ 517	\$4,145
Total assets	341	4,513	1,047	5,404	2,018	6,030
Long-term obligations	25	75	75	83	80	84
Total stockholders' equity (1)	10	2,829	244	3,989	561	4,608

- (1) Includes mandatorily redeemable Preferred Stock which will be automatically converted into Common Stock as of the closing of this offering.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

The Company experienced substantial growth in revenues since product shipments began in September 1986. Results for successive quarters reflected the increasing market acceptance of the Company's products and expansion of the Company's marketing and sales efforts. Substantially all of the Company's revenues to date have been derived from the sale of LAN analysis products.

Fiscal 1988 revenues were approximately nine times fiscal 1987 revenues. As a consequence, year to year comparisons of costs and expenses are not considered meaningful because of the vastly different levels of operations.

The following tables set forth certain quarterly financial information. This information is derived from unaudited financial statements which include, in the opinion of management, all normal, recurring adjustments which management considers necessary for a fair statement of the results for such periods. The operating results for any quarter are not necessarily indicative of results for any future period.

	Three Months Ended						
	June 30, 1987	Sept. 30, 1987	Dec. 31, 1987	March 31, 1988	June 30, 1988	Sept. 30, 1988	Dec. 31, 1988
	(in thousands, except per share data)						
Revenues	\$ 718	\$ 854	\$1,622	\$1,717	\$2,582	\$2,891	\$3,381
Cost of Revenues	157	190	383	399	549	614	875
Gross profit	561	664	1,239	1,318	2,033	2,277	2,506
Operating Expenses:							
Marketing and sales	163	191	429	519	733	943	1,033
Research and development	91	98	79	97	175	208	248
General and administrative	140	138	210	200	202	192	230
Income from operations	167	237	521	502	923	934	995
Interest Income (Expense), net	—	3	6	24	36	40	36
Income before taxes	167	240	527	526	959	974	1,031
Provision for Income Taxes	72	103	227	226	383	389	413
Net income	\$ 95	\$ 137	\$ 300	\$ 300	\$ 576	\$ 585	\$ 618
Earnings per Share	\$.03	\$.04	\$.08	\$.06	\$.12	\$.12	\$.13
Weighted Average Shares							
Outstanding	3,579	3,579	3,625	4,847	4,847	4,847	4,847
	As A Percentage of Revenues						
Revenues	100%	100%	100%	100%	100%	100%	100%
Cost of Revenues	22	22	24	23	21	21	26
Gross profit	78	78	76	77	79	79	74
Operating Expenses:							
Marketing and sales	23	22	26	30	28	33	31
Research and development	13	11	5	6	7	7	7
General and administrative	19	16	13	12	8	7	7
Income from operations	23	28	32	29	36	32	29
Interest Income (Expense), net	—	—	—	1	1	1	1
Income before taxes	23	28	32	31	37	34	31
Provision for Income Taxes	10	12	14	13	15	13	12
Net income	13%	16%	18%	17%	22%	20%	18%

Over the past seven quarters, sales of the Company's products have increased by over 370%. Sales for the quarter ended December 31, 1988, were 108% greater than sales for the quarter ended December 31, 1987. However, the Company does not expect to sustain these rates of growth in the future. Increases in sales from quarter to quarter have varied considerably, ranging from a low of 6% to a high of 90%, with sales for the Company's quarter ended December 31, 1988, representing a 17% increase over the immediately preceding quarter. Sales to international distributors accounted for 22% of revenues in fiscal 1988 and 13% of revenues for the nine-month period ended December 31, 1988. See Note 2 to Consolidated Financial Statements.

Cost of revenues consists of manufacturing costs and warranty expenses. Gross profit varies from quarter to quarter due to factors including changes in the relative proportion of international and domestic sales, changes in product mix, new product introductions and price changes. During the six quarters ended September 30, 1988, gross profit varied from 76% to 79% of revenues, but in the quarter ended December 31, 1988, gross profit declined to 74% of revenues. This decrease was due primarily to significant increases in sales of the Company's recently introduced Series 300 and 500 products combined with a significant decrease in sales of its older Series 400 products. The Series 300 and 500 products generally produce lower gross profits than do the Series 400 products. See "Business — Products." Gross profits in the December 31, 1988 quarter were also affected by a decrease in sales to OEM customers, which generally produce very high gross profits, partially offset by higher gross profits on international sales due to a favorable product mix on these sales. Gross profit may vary in future quarters due to the same factors as in the past, as well as to potential price reductions that could result from competitive pressures and to other factors.

The Company's marketing and sales expenses have increased as a percentage of revenues over the last seven fiscal quarters, from 23% in the first quarter of fiscal 1988 to 33% and 31% in the second quarter and third quarter, respectively, of fiscal 1989. These increases are largely the result of significantly increased marketing expenditures, including those for advertising, collateral materials, trade shows, sales training and sales promotions, and increased compensation expenses due to expansion of the marketing and sales staff. Marketing and sales expenses as a percentage of revenues also reflect, in part, the mix of domestic and international sales, since the Company incurs higher sales commission expense on domestic sales.

The Company believes that continued commitment to research and development is required to remain competitive. Research and development expenses consist primarily of salaries and benefits, occupancy expenses and fees paid to outside consultants. Although expenditures for research and development over the past seven fiscal quarters have increased over 170%, research and development has declined as a percentage of revenues from 13% in the first quarter of fiscal 1988 to 7% in the third quarter of fiscal 1989 due to significant increases in revenues. While expenditures for salaries and benefits have increased throughout this period, variations in the utilization of consultants have resulted in fluctuations in the overall level of expenditures for research and development. The Company anticipates that salaries and benefits for research and development will continue to increase as permanent employees are hired. See "Business — Product Development" and "Employees."

Research and development expenses are accounted for in accordance with FASB Statement No. 86, under which the Company is required to capitalize software development costs after technological feasibility is established. Capitalizable software development costs incurred to date have not been significant and, thus, the Company has charged all software development costs to expense in the statement of operations.

The Company has been able to support its significant revenue increases during the past five quarters without significantly increasing its level of general and administrative expenditures. As a result, general and administrative expenses have declined from 13% of revenues to 7% of revenues during that period.

Net interest income has represented approximately one percent of revenues for the fiscal quarters following the closing of the Company's preferred stock financing.

The Company accrued provisions for income taxes of 43% and 40% for fiscal 1988 and the first nine months of fiscal 1989, respectively. This decrease reflects the statutory decrease in federal income tax rates.

Liquidity and Capital Resources

The Company has financed its operations to date through cash flow from operations and the private sale of approximately \$2,000,000 of convertible preferred stock. The amount of the Company's capital commitments through fiscal 1989 is currently not material.

As of December 31, 1988, the Company's principal source of liquidity included cash and investments of approximately \$2.4 million. The Company currently has no borrowings and has no established bank lines of credit. The Company believes that the proceeds from the sale by the Company of the Common Stock offered hereby, together with existing sources of liquidity and anticipated funds from operations, will satisfy the Company's projected working capital and capital expenditure requirements at least through fiscal 1990.

BUSINESS

Network General designs, manufactures, markets and supports software-based LAN analysis tools for a broad spectrum of physical connection technologies and communications protocols. The Company's family of products, marketed as "The Sniffer", enables customers to resolve LAN problems in a cost-effective manner. These products monitor the network, capture data packets for analysis and analyze protocols and network traffic. All of the Company's Sniffer products are based upon a common architecture and consist of the Company's proprietary software, one or more network connection cards and one of three PC/AT compatible hardware platforms.

Network General believes that its products are the only LAN analysis tools currently available for use across all the principal configurations of LAN physical connection technologies and protocols. While its major competitors offer products which support only Ethernet and StarLAN, Network General offers products supporting 4 Mbit Token-Ring, 16 Mbit Token-Ring, ARCNET and IBM PC Network Broadband in addition to Ethernet and StarLAN. The Company also offers detailed interpretation of a greater range of communications protocols than its competitors and believes it is the only vendor to offer automatic recognition and in-depth interpretation of protocols at all seven layers of the ISO model.

Background

Distributed computing resources, such as personal computers, workstations, servers and printers, have proliferated in recent years due to the declining cost and increasing performance of computer hardware. The large and rapidly expanding number of these resources represents a key factor in the acceptance of LAN technology. LANs allow increased productivity and utilization of distributed computers through the sharing of resources, the transfer of information and the processing of data at the most efficient location. LANs also can overcome the incompatibility of different vendors' computer products by allowing these products to communicate with each other.

As organizations have recognized the economic benefits of using LANs to connect distributed computing resources, LAN suppliers have rapidly increased the capabilities of networking products and applications. Network applications such as electronic mail, file transfer, host access and shared data bases have been developed as means to increase productivity. This increased sophistication in conjunction with the growing number of distributed computing resources has fueled rapid expansion in the number of installed LANs. The growing number of distributed processing and information sharing applications, which typically involve larger segments of the organization than simple resource sharing, has also led to an increase in the average size of networks.

As networks have grown in size and complexity, they have become more likely to develop problems, and the problems have tended to be more difficult to diagnose. The performance of a network can suffer due to a variety of causes which include inefficient routing of information, transmission of unnecessarily small packets of information, improper device or network configuration and superfluous "broadcast" messages. Specific network applications may also contain design flaws which affect their performance or inhibit access to certain resources on the network. These problems are compounded by the fact that most networks are constantly changing and evolving. Change, whether due to growth, reconfiguration or new applications, frequently introduces problems in networks that were previously functioning well. Further compounding these problems is the trend toward LANs encompassing equipment from multiple vendors, using multiple connection technologies and concurrently operating with multiple communications protocols.

Growing numbers of organizations are depending upon LAN-based distributed data processing as an integral part of their business strategies. Distributed data processing through a LAN results in the network, and the computing resources on it, effectively becoming the processor of vital applications. Applications such as order-entry and reservation systems, critical to conducting business, now frequently reside on networks. The potentially enormous financial consequences of network problems can make it unacceptable for the LAN to be down, slow or error-prone.

Without LAN analysis tools which offer visibility as to how and where data is moving on the network, the LAN user has no means to monitor and analyze performance effectively or to isolate problems for quick resolution. To date, LAN vendors have offered relatively few solutions which meet the growing need for such analysis tools. As a result, network users have typically attempted to resolve these problems on a trial-and-error basis, which can be time consuming and inefficient and can fail to isolate the problem.

Network General's Strategy

Network General's strategy is to supply software-based network monitoring and analysis tools which provide the capability to identify, analyze and resolve increasingly complex problems for LANs utilizing all prominent physical connection technologies and communications protocols. The Company anticipates that its customers will continually modify their LANs to take advantage of improvements in LAN technology and enhancements in LAN applications. The Company intends to modify its current products and introduce new products in a timely fashion in order to address these changing market requirements. The Company's customers vary widely in their understanding of the details of LAN technology, and the Company intends to preserve the product features which enable relatively unsophisticated customers to utilize these products productively.

The Company's current products, the Sniffer family, are LAN monitoring and analysis tools which are based upon a common architecture. These tools allow customers to observe and decode traffic on their LANs, thereby enabling them to anticipate or diagnose LAN problems. A Sniffer consists of the Company's proprietary software, one or more network connection cards, and one of several PC/AT compatible hardware platforms. These products share a consistent user interface and were designed to readily accommodate the substitution of alternate connection technologies and additional protocol interpretation modules. The Company believes that its products are currently the only monitoring and analysis tools available for use in LANs across all the principal physical connection technologies and communications protocols.

The Market for LAN Analysis Tools

Potential customers for LAN analysis tools include both the network management and field service personnel directly responsible for supporting the operation of sophisticated LANs and engineers engaged in the development of network products and applications. Most of the Company's initial customers could be classified as LAN software/hardware developers, but the Company's sales to LAN management personnel have increased more rapidly, making that segment currently the largest source of the Company's revenues. The Company believes that a relatively small proportion of its potential customers have purchased a LAN analysis tool to date. The number of such potential customers is expected to expand significantly as increasing numbers and varieties of LAN applications are developed and installed, resulting in expansion of existing LANs as well as new LAN installations. See "Distribution, Marketing and Customers — Customers."

LAN management personnel

The Company's largest group of customers can be classified as LAN management personnel. Generally, these users are charged with the management of a network which serves either a department or a division of a large organization. The Sniffer enables LAN managers to do their jobs more efficiently and provides the following benefits to the organization:

1. **Improved Productivity.** While a large LAN represents a major investment in data processing hardware and software, the costs associated with the system users who depend upon the LAN represent a significant multiple of this investment. Consequently, even small percentage changes in user productivity as the result of the LAN functioning more smoothly or running faster can yield savings far in excess of the cost of a LAN analysis tool such as the Sniffer.

2. **Faster Problem Resolution.** Large LANs generally contain products from several vendors. When a problem arises on the LAN, it can be extremely difficult to identify the vendor responsible

and this may result in significant delays in problem resolution. The Sniffer may enable the user to identify the problem and, hence, the appropriate vendor.

3. ***Fewer Problems with Critical Applications.*** Increasingly, applications that support customers, such as reservation, transaction, or order-entry systems, are being run over LANs. Poor performance and downtime are not acceptable in these environments since obtaining and retaining customers depend upon the effective operation of the LAN. The Sniffer assists the network manager in preventing LAN problems with these applications.

LAN software/hardware developers

LAN software/hardware developers include most data communications and data processing vendors as well as large sophisticated end-user organizations developing their own applications. An example of the latter kind of customer would be an airline developing a reservation system application to run on a LAN. These software/hardware developers are generally extremely sophisticated in their understanding of LAN technology and are able to take full advantage of the Sniffer's capability to provide in-depth packet analysis at several protocol layers and to service multiple connection technologies. LAN analysis tools such as those marketed by the Company provide the following benefits to these customers:

1. ***Reduced Development Expense.*** Eliminating the trial-and-error problem resolution process shortens the time required for developing a new product. Given very high engineering costs per man year, even modest savings in development time can yield a quick payback on the investment in a Sniffer.

2. ***Decreased Time to Market.*** Market success is often determined by the speed with which a product can be brought to market. The Company's LAN analysis tools can enable developers to complete the development process sooner. Even a small improvement in time to market can be worth many times the investment in a Sniffer.

3. ***Enhanced Reliability.*** Utilization of the Sniffer can allow the developer to produce a more reliable product and one that conforms exactly to the published specifications for that protocol. Since the Sniffer allows direct observation of the details of all data packets captured from the LAN, design flaws can be eliminated at the source. Improved reliability enhances customer acceptance of the product and reduces support costs.

LAN field service organizations

Many data processing and data communications organizations offer service options to their customers which include either servicing the customer's entire LAN or servicing only the equipment and software which they have supplied. In either case, determining whether the problem is caused by products which they have supplied or by products supplied by others is an ongoing issue for these field service organizations. Diagnostic tools, including LAN analysis tools of the type marketed by the Company, are extremely useful in resolving such issues. Benefits to these organizations can include:

1. ***Increased customer satisfaction.*** The Sniffer allows field service organizations to resolve customer problems more rapidly, resulting in enhanced customer satisfaction.

2. ***Reduced service expense.*** The ability to resolve problems rapidly results in reduced cost of service.

3. ***Increased efficiency in utilization of technical experts.*** The Company's products allow relatively unskilled field service personnel to isolate the customer problem at the source for remote analysis by technical experts. As a consequence, the involvement of technical experts, including development personnel, in replicating and resolving problems can be significantly reduced.

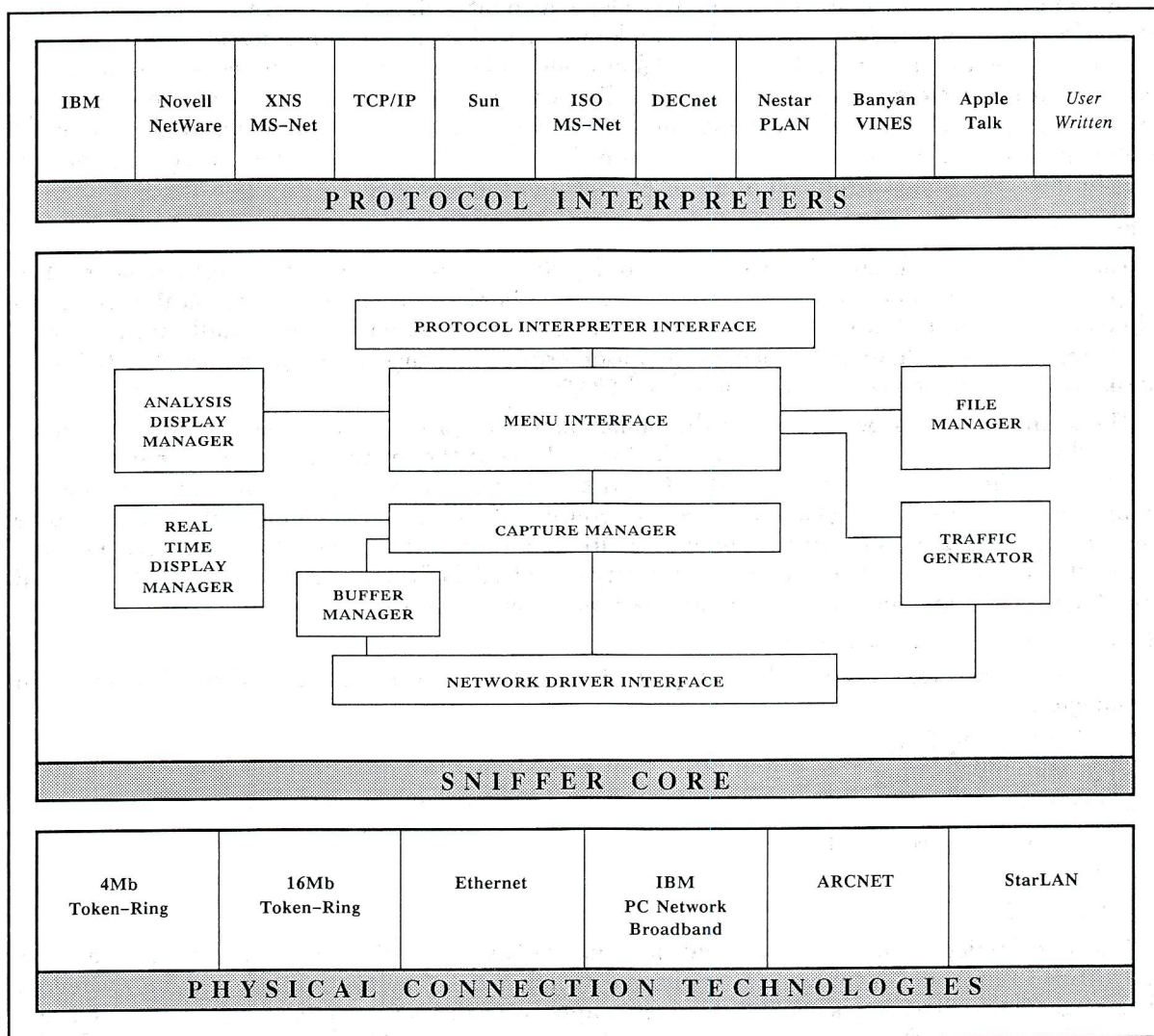
Technology and Architecture

The Sniffer products are based on a common architecture and consist of proprietary software and the hardware necessary to run this software. Network General's software is written so that it is adaptable to PC/AT compatible products utilizing an 80286 or 80386 microprocessor. The Company

has minimized customization of hardware or dependence upon specific hardware in the belief that its customer base will be best served by preserving the Company's option to select among the large variety of PC/AT compatible products which are rapidly improving in price and performance. In order to minimize customer problems with installation and support, the Company offers its software packaged on portable platforms which have been thoroughly tested with the software. Currently, these platforms are the COMPAQ Portable II Model 4, the Toshiba T3200 laptop, and the COMPAQ Portable 386. For the COMPAQ Portable 386 only, the Company offers customers the option of supplying their own hardware platform and installing the software and a specially designed adaptor module.

The Company's proprietary software consists of approximately 200,000 lines of code written in a combination of assembly language and C. The software is based upon an architecture designed to allow easy addition of physical connection technologies and/or new protocol interpreters. This is achieved by utilizing a proprietary Sniffer core with proprietary interfaces to physical connection technologies and to the Company's proprietary protocol interpreters, as illustrated below.

SNIFFER ARCHITECTURE



The Sniffer core contains the software which is independent of both the protocol interpreters and the physical connection technologies. The core manages the network data flow from the network driver interface and provides efficient access to the hardware platform's multi-megabyte capture buffer. The Sniffer core provides a consistent interface to the protocol interpreters and a library of both interpreted and compiled-code routines which are used by the interpreters during LAN analysis. In order to support high performance filtering of data packets during both capture and display, the Sniffer core dynamically compiles these user-selected filters into highly efficient machine code. All interaction with the user is implemented in the Sniffer core by a unique user interface and display menuing system. Also included in the Sniffer core module are traffic generation and file management capabilities.

Different software is written for each physical connection technology. This software, largely written in assembly language, must manage the capture of packets of information in real time for display and later analysis. It is extremely important that this software be highly efficient since the Sniffer examines all of the data packets on the network rather than just packets destined for a particular node. In order to capture the data packets on certain high speed networks such as Ethernet, portions of this software are executed directly on intelligent communications cards.

The protocol interpretation software must efficiently decode software communications protocols. This is technically difficult because: (i) there is a large amount of data which must be analyzed rapidly, (ii) interpretation of this data requires detailed knowledge of specific communications protocols, and (iii) the meaning of a specific field in some higher layer packets may vary as a function of information contained in the same packet or prior packets. The Company believes it is the only vendor whose software incorporates the highly complex algorithms which enable interpretation of these context sensitive protocols. The Company also believes it is the only vendor to offer automatic recognition and in-depth interpretation of protocols at all seven layers of the ISO model.

Products

Customers have substantial flexibility in configuring a Sniffer to meet their requirements. The Company currently offers the ability to choose combinations of up to six physical connection technologies and up to ten protocol interpreter suites installed on one of three hardware platforms. Depending on the configuration selected, end-user prices can range from approximately \$12,500 to \$60,000, with an average selling price of around \$20,000.

While the functions performed by the Sniffer family of products are complex, a great deal of design effort has gone into making the installation and use of the Sniffer extremely simple. With the exception of the module version of the COMPAQ Portable 386, no customer configuration or modification is necessary. Installation of a Sniffer consists of connecting the unit to the network to be analyzed and turning on the power. A unique, multi-window user interface with an intuitive menuing system allows customers to become productive very quickly. All of these features, which are contained in the Sniffer core, are consistently implemented on all models of the Sniffer.

Physical Connection Technologies

Currently, the Company is able to capture information from six different physical connection technologies:

- 4 Mbit Token-Ring
- 16 Mbit Token-Ring
- Ethernet
- IBM PC Network Broadband
- ARCNET
- StarLAN

These technologies represent both industry standards such as IEEE 802.3 (Ethernet) and IEEE 802.5 (Token-Ring) and manufacturer sponsored technologies that may or may not be related to industry standards. StarLAN, an AT&T product, conforms to the 802.3 standard, while ARCNET and IBM PC Network Broadband are non-standard and are sponsored by Datapoint Corporation and IBM, respectively. While many other types of connection technologies have been marketed, the Company

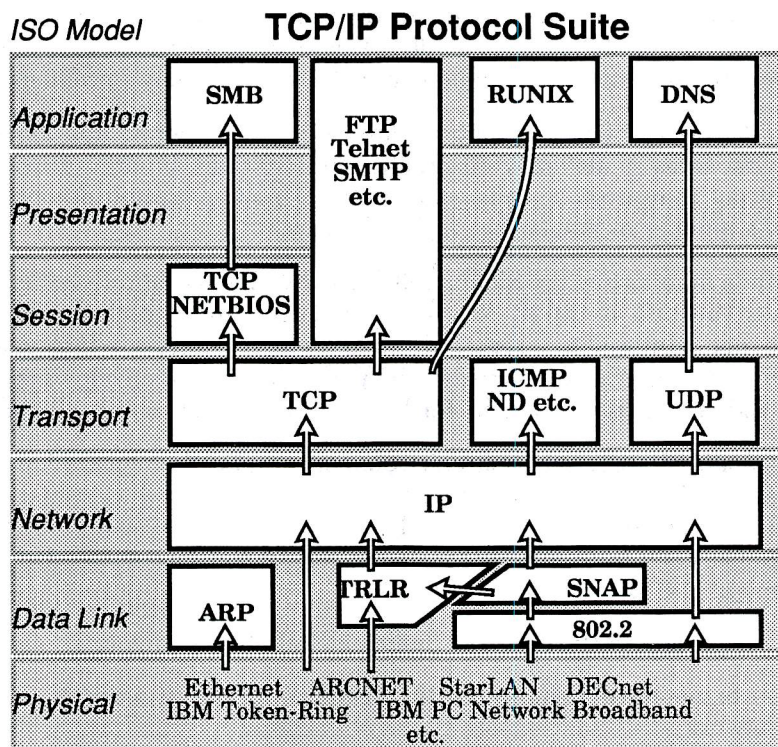
believes that most medium or high-speed networks installed utilize one of these six technologies. The Company's major competitors only address Ethernet and StarLAN connection technologies. No significant competitor offers the ability to capture traffic from the remaining four connection technologies.

Protocol Interpreters

The Company offers the following protocol interpreter suites:

- IBM
- Novell NetWare
- XNS/MS-Net
- TCP/IP
- Sun
- ISO/MS-Net
- DECnet
- Nestar PLAN
- Banyan VINES
- AppleTalk

Each of these protocol interpreter suites actually interprets several communications protocols. These range from the protocols establishing linkage to the physical media ("Physical" and "Datalink", which are the two lowest layers of the ISO model) to the protocols managing the specific application being executed ("Application", which is the highest layer of the ISO model). The Company believes it is the only vendor to offer automatic recognition and in-depth interpretation of protocols at all seven layers of the ISO model. The Company has developed approximately one hundred twenty separate protocol interpreters which are combined into the suites listed above. For example, the TCP/IP protocol interpreter suite actually includes interpretation of many specific protocols at various layers of the ISO model as shown below:



In addition to the families of protocol interpreters provided by the Company, users can write their own protocol interpreters. This is possible because the Company provides a defined and documented interface for user-written protocol interpreters.

Hardware Platforms

The Company currently markets its LAN analysis software in three portable hardware series:

- **The 300 Series.** This series utilizes the Toshiba T3200 laptop, which is an 80286 based processor that runs at 12 Mhz, has a standard 40 MB hard disk drive and is marketed with 4 MB of memory. The Company offers the Series 300 Sniffers configured for use with any one of the six available physical connection technologies selected by the customer.
- **The 400 Series.** This series utilizes the COMPAQ Portable II Model 4, which is an 80286 based processor that runs at 8 Mhz, has a standard 20 MB hard disk drive and 640 KB of memory. An optional expansion to 2.6 MB of memory is available. The Company offers this model of the Sniffer configured for use with one or two of the six available physical connection technologies as selected by the customer.
- **The 500 Series.** This series, introduced in September 1988, utilizes the COMPAQ Portable 386, which is an 80386 based processor that runs at 20 Mhz, has a standard 40 MB hard disk drive and is marketed with 6 MB of memory with an option to expand to 10 MB. The Company also offers customers the option of supplying their own COMPAQ Portable 386, in which case the customer acquires only the Sniffer software and a special connection module from the Company. The architecture of the Series 500 Sniffer permits the customer to access any of the six physical connection technologies through the use of optional connection modules.

Product Features

The Company's products can be used for monitoring network traffic, capturing data packets for analysis and analyzing protocols. Several options are available during both capture and analysis which allow the user to extract relevant information easily. This variety of options, easily accessible through an intuitive multi-window interface, is a unique feature of the Company's products.

Monitoring. A variety of display options are available to permit the customer to monitor trends in such vital areas as network utilization, active stations, number of packets transmitted, and other significant indicators of network activity. This information can be displayed, at the user's option, in a number of tabular or graphic formats.

Capture. While monitoring, the Sniffer collects packets in its capture buffer for later analysis. Captured packets can also be saved to disk. Standard features include filters which discard packets that do not conform to user established criteria, triggers which allow capturing to commence or stop upon user defined events, and packet slicing which allows the capture of more packets in the random access memory buffer by eliminating portions of the packets captured.

Protocol Analysis. Protocol analysis can commence upon the completion of the capture of relevant data packets. Protocols are automatically recognized and interpreted into their English equivalents and are fully decoded through all levels of the ISO model. For those customers utilizing an optional color monitor, protocols are automatically color coded according to the appropriate layers of the ISO model.

Other standard operational features of the Sniffer include the following:

- The ability to generate traffic to test the operation of the network as a whole or a specific station on the network.
- The ability to operate the product remotely via a telephone modem link utilizing a feature called the TeleSniffer.
- The ability to export files captured from the network to popular spreadsheet and database programs such as Lotus 1-2-3 and dBase for further analysis or display.

The Company has released enhancements to its products approximately two times per year and has made these enhancements available to customers with units under warranty for a nominal charge and to others for a fee.

Distribution, Marketing and Customers

Distribution

The Company sells its products to end-users in the United States through manufacturer's representative organizations, to international end-users through international distributors, and to selected OEMs. In the United States, the Company has an active marketing program that generates sales leads for follow-up by these manufacturer's representatives. Internationally, the Company's distributors have responsibility for local marketing programs.

The Company currently has nonexclusive territorial agreements with sixteen manufacturer's representatives covering the United States. These representatives employ an aggregate of approximately seventy experienced professional sales people who are technically competent to represent products such as those offered by the Company. Purchase orders to the Company are solicited for the Company's products based upon sales leads which are typically generated by the Company's marketing efforts. The Company actively monitors the representatives to make sure the leads are pursued appropriately. Unsatisfactory performance can lead and has led to either termination of the manufacturer's representative or the appointment of an additional representative in the same geographical area. Representatives are compensated through commissions which are payable only upon collection from the customer. Approximately 78% of the Company's revenues for the first three quarters of fiscal 1989 were generated from this sales channel. During this period, one manufacturer's representative organization, Jordan Electronics, Inc., accounted for 12% of the Company's revenues.

The Company's manufacturer's representatives and distributors also represent other lines of products which are complementary to those of the Company. While the Company attempts to encourage these representatives and distributors to focus on its products through marketing and support programs, there is a risk that representatives or distributors may give higher priority to products of other suppliers, reducing their efforts to sell the Company's products.

Sales to end-users outside of the United States are made principally through fifteen international distributors which market, sell and service the products in Europe, Asia, Canada and Australia. Generally, the Company has entered into exclusive country-wide agreements with these distributors. However, the Company retains the option to terminate these relationships or make them non-exclusive if sales quotas are not attained. Although the Company has principally focused its marketing effort on the domestic market, international sales accounted for approximately \$1,083,000 and \$1,123,000 in revenues in fiscal 1988 and in the first nine months of fiscal 1989. Sales through this channel accounted for 13% of the Company's revenues during the first three quarters of fiscal 1989. These export sales are subject to certain government controls, but to date the Company has not experienced any material difficulties related to such restrictions. All of the Company's international sales are denominated in United States dollars.

The Company has also entered into licensing arrangements with six OEM customers. This alternate channel of distribution accounted for approximately 9% of the Company's revenues during the first three quarters of fiscal 1989.

Marketing

In support of United States distribution of its products, the Company has several active marketing campaigns designed to generate sales leads. The Company has participated frequently in industry trade shows, advertised consistently in the trade press and devoted a significant amount of senior management attention to press briefings. The Company has also provided units at no charge to selected network training institutes for use in their courses and, through a rental program, has provided

potential customers with the opportunity to use the Sniffer before making a purchase decision. These activities have resulted in high visibility for the Company and its products, including favorable recognition in several important trade publications.

In addition, the Company has actively sought to establish cooperative relationships with certain networking industry leaders in order to be in a position to support new developments in networking as soon as possible. An example of this kind of relationship is the Company's recent announcement of a 16 Mbit Token-Ring protocol analyzer simultaneous with the announcement by Texas Instruments Incorporated of its 16 Mbit Token-Ring chip set. Another is Microsoft Corporation's recent adoption of the Sniffer as a tool for use in their advanced LAN product development, and their agreement to continue to provide Network General with advanced information on protocol extensions and enhancements made by Microsoft. The Company believes that these relationships are made possible by the fact that the Company, unlike its principal competitors, does not offer network products in competition with these industry leaders. See "Product Development."

Service

Network General services and supports its products directly. Its products are sold with one year of warranty included in the price. Warranty costs to date have not been significant. The Company also offers maintenance agreements for a fixed fee after the one year warranty period. Customers with units under warranty receive new software releases of the Company's products for a nominal charge. New software releases are available to customers with units under maintenance agreements for a nominal charge. Under the terms of the warranty and the maintenance agreements, customers receive telephone support during normal business hours. Customers with product problems which cannot be solved over the telephone may ship their Sniffers to the Company's offices in Mountain View, California, for repair or replacement. As a result of the Company's concentration on providing highly reliable products, costs of providing this service and support have not been significant.

Customers

As of December 31, 1988, Network General had shipped over 500 units to more than 300 customers. Purchasers of the Company's products include 37 of the Fortune 100 industrial companies and 40 of Datamation's top 100 data processing vendors. In addition, the Company has provided products to many leading education, government and health care institutions. While initially most of the Company's customers were data processing vendors, this segment currently represents approximately 25% of the Company's sales. One customer accounted for approximately 11% of revenues in fiscal 1987, but no single customer accounted for more than 6% and 3% of revenues during fiscal 1988 and the first nine months of fiscal 1989, respectively.

Purchasers of the Company's products have included the following:

Data Processing

Apple Computer Inc.
Compaq Computer Corporation
Control Data Corporation
Data General Corporation
Digital Equipment Corporation
Hewlett-Packard Company
International Business Machines Corporation
Microsoft Corporation
NCR Corporation
3Com Corporation

Financial Services

Aetna Life & Casualty Company
Barclay's American Corporation
The Bear Stearns Companies, Inc.
The Chase Manhattan Bank, N.A.
Citibank N.A.
CNA Financial Corporation
London Stock Exchange
Primerica Corporation
Shearson Lehman Hutton Inc.

Industrial

Amoco Corporation
Chrysler Corporation
Dow Chemical Company
General Dynamics Corporation
Hughes Aircraft Company
Litton Industries Inc.
Minnesota Mining & Manufacturing Co.
Owens-Corning Fiberglas Corporation
Rockwell International Corporation
Westinghouse Electric Corporation

Telecommunications

American Telephone & Telegraph Company
Bell Northern Research
Bell Canada
Indiana Bell Telephone Company
Mountain States Telephone & Telegraph Company
NYNEX Corporation
Pacific Telesis Group
Southern Bell Telephone & Telegraph Company
Southwestern Bell Telephone Company
US WEST

Government

City of Tempe, Arizona
Florida Division of Corporations
General Services Administration
Lawrence Livermore National Laboratory
National Science Foundation
Texas Department Human Resources
Pentagon
U.S. Department of Army
Federal Aviation Administration

Education

Baylor University
Case Western Reserve University
Dartmouth College
Georgia Institute of Technology
University of Michigan
Northwestern University
Princeton University
Stanford University
State University of New York
Vassar College

All of the customers listed above have purchased at least one Sniffer and many have purchased multiple units. Since the market for LAN analysis tools is new, purchasing patterns of existing and potential customers have not yet become clear. As a result, it is difficult for the Company to precisely estimate the requirements of its customers and, therefore, the size of its potential market.

Competition

A substantial number of companies, both large and small, are currently marketing some form of LAN analysis tool. Nonetheless, the Company's principal competitors to date have been Excelan, Inc. and Hewlett-Packard Company. These companies have greater name recognition, more extensive engineering, manufacturing and marketing capabilities and substantially greater financial, technological and personnel resources than those available to the Company. Network General competes on the basis of several product features, including speed of operation, ease of use, protocol layers decoded, breadth of technologies and protocols supported, and the variety and relevance of analysis features. To a lesser extent, the Company also competes on the basis of price. Despite the fact that its products are

generally priced higher than those of its principal competitors, the Company has been able to compete successfully due to the functional advantages of its products versus those of its competitors.

The LAN industry is characterized by rapid technological advances and can be significantly affected by product introductions and market activities of industry participants. In addition to its current principal competitors, the Company expects substantial competition from established and emerging computer, communications and test instrument companies. There can be no assurance that the Company will be able to compete successfully in the future with these existing or anticipated competitors and the effects of such competition could be more adverse than would be the case if the Company had a broader product line. In particular, competitive pressures from existing or new competitors which offer lower prices or introduce new products could result in price reductions that would adversely affect the Company's operating margins. The Company's ability to compete successfully with current and potential competitors will depend to a significant extent on its ability to continue developing technologically superior products and adapt to changes in its market.

Product Development

Dr. Harry J. Saal and Dr. Leonard J. Shustek, the Company's founders, developed the technology which serves as the basis for the Company's Sniffer products (the "Technology") while employed at Nestar. Pursuant to an agreement entered into between Nestar and the Company in May 1986, the Company acquired exclusive ownership of the Technology and all related documentation. Utilization of the Technology, developed over a number of years at Nestar, allowed rapid introduction of the first version of the Sniffer.

The Company believes that its future success depends on its ability to continue to enhance its existing products and to develop new products that maintain technological leadership, meet a wider range of customer needs and achieve market acceptance. Accordingly, the Company intends to focus its product development efforts on network analysis products that permit remote diagnostics and monitoring and support additional connection technologies and protocols. In order to successfully develop certain of these new products, the Company is dependent upon timely access to information about new developments relating to such technology and standards. There can be no assurance that such information will continue to be available, that the Company will be able to develop and market new products successfully or that the Company will be able to respond effectively to technological changes or new product announcements by others.

During fiscal 1987 and 1988 and the first nine months of 1989, research and development expenses were approximately \$158,000, \$365,000 and \$631,000, respectively. To date, all of the Company's research and development expenses have been charged to operations as incurred. The Company has engaged in some customer-sponsored research and development activities relating to its OEM agreements but believes that the expenses associated with these agreements have not been material.

Manufacturing and Suppliers

The Company's manufacturing operations consist primarily of final assembly and test and quality control of materials, components, subassemblies and systems. The Company believes its quality control procedures have been instrumental in achieving the high performance and reliability of its products. To date, the Company has experienced negligible customer returns of its products. The Company presently uses third parties to perform printed circuit board assembly.

The Company's reliance on third party suppliers involves several risks including limited control over quality and delivery schedules. In the past, quality control problems on the platforms supplied to the Company have caused delays in shipments of the Company's products. The Company does not currently have a long-term contract with its suppliers and acquires hardware through distributors on a purchase order basis. If the Company experiences significant quality control problems or supply shortages in the future, its revenues and profitability could be adversely affected.

While the total time elapsed from first contact with a potential customer to receipt of a valid purchase order can typically consume three to six months, the Company attempts to ship its products to customers within two weeks of receipt of a complete and correct purchase order. Backlog of orders generally represents less than one month's revenues and, as such, is not considered material.

Proprietary Rights and Licenses

The Company does not hold any patents and relies upon copyright, trademark and trade secret laws to establish its proprietary rights in its products. Because the LAN industry is characterized by rapid technological change, the Company relies principally upon innovative management, technical expertise and marketing skills to develop, enhance and market its products.

The Company's two founders developed the Technology while employed at Nestar. The Company acquired exclusive ownership of the Technology through a May 1986 agreement with Nestar. As the consideration for the Technology, the Company paid Nestar cash and granted Nestar a perpetual, non-exclusive and royalty free license to manufacture and use the ARCNET Sniffer product line for internal purposes only. Simultaneously, Drs. Saal and Shustek resold all of their shares of Nestar Common Stock to Nestar and purchased certain equipment from Nestar. Nestar also was granted the right to continue manufacturing and selling the ARCNET Sniffer board being manufactured by Nestar at the time of the agreement in exchange for a royalty to the Company of 15% of Nestar's gross profit on the product. The Company understands that, to date, no ARCNET Sniffer boards have been sold by Nestar and, accordingly, no royalty payments have been received from Nestar.

Employees

As of December 31, 1988, the Company employed a total of 31 persons, including 13 in marketing and sales, 6 in product development, 6 in manufacturing, and 6 in management, administration and finance. As part of its strategy of keeping fixed costs as low as possible, the Company has utilized the services of manufacturer's representatives, consultants and other vendors extensively in its sales, development and manufacturing activities. The Company anticipates that an increasing portion of its research and development in the future will be performed by Company employees rather than outside consultants. None of the Company's employees is represented by a labor union. The Company has experienced no work stoppages and believes that its employee relations are good.

Competition in the recruiting of personnel in the computer and communications industry is intense. The Company believes that its future success will depend in part on its continued ability to hire and retain qualified management, marketing and technical employees and independent contractors.

Properties

The Company's principal administrative, marketing, manufacturing and product development facilities consist of 10,500 square feet in a modern building in an office park in Mountain View, California. The Company occupies this space under a sublease agreement that expires in July 1990. See Note 5 to Consolidated Financial Statements.

The Company may expand its facilities during fiscal 1990, and expects that suitable additional or substitute space will be available as needed.

MANAGEMENT

Directors and Executive Officers

The directors and executive officers of the Company are as follows:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Harry J. Saal	45	President, Chief Executive Officer and Director
Leonard J. Shustek	40	Executive Vice President, Research and Development, Secretary and Director
George E. Comstock	65	Vice President, Marketing and Sales
Roger C. Ferguson	46	Vice President, Operations, and Chief Financial Officer
Michael C. Child	34	Director

Dr. Saal, a founder of the Company, has served as President and a director of the Company since its inception in May 1986. He also was the Company's Chief Financial Officer from May 1986 until November 1987. In 1978, Dr. Saal and Dr. Shustek co-founded Nestar Systems, Incorporated, a producer of local area network systems for personal computers. Dr. Saal served as the President of Nestar from its inception until January 1984, and was Chief Scientist from January 1984 to May 1986. He is also a director of Personal Computer Products, Inc. He holds a PhD in High Energy Physics from Columbia University.

Dr. Shustek, a founder of the Company, has served as Secretary and a director of the Company since its inception. Dr. Shustek also served as the Company's Vice President, Research and Development, from its inception until May 1987, at which time he was promoted to the position of Executive Vice President, Research and Development. Dr. Shustek was employed by Nestar as its Vice President, Research and Development, from October 1978 to April 1984, and as its Vice President of Future Technology from April 1984 to May 1986. He holds a PhD in Computer Science from Stanford University.

Mr. Comstock has been the Vice President, Marketing and Sales, of the Company since November 1986. From June 1985 to November 1986, Mr. Comstock worked as an independent marketing consultant. He also founded and worked from 1977 to 1983 as the President of Durango Systems, Inc., a producer of supermicrocomputers for business applications. Mr. Comstock also served as the President of Diablo Systems, Inc., a producer of components for computer printers, from July 1969 to mid 1977. He holds a BS in both Electrical Engineering and Mechanical Engineering from Worcester Polytechnic Institute and was named an honorary Doctor of Engineering by that institute. He also holds an MS in Physics from California Institute of Technology.

Mr. Ferguson has served as Vice President, Operations, and Chief Financial Officer of the Company since December 1987. From October 1984 to June 1987, he served as the Chief Financial Officer and Executive Vice President of Sytek, Inc., a producer of networking products. From October 1982 to October 1984, Mr. Ferguson held the positions of Vice President and Controller of General Instrument Corporation. He received his BA from Dartmouth College and an MBA from the Amos Tuck School of Business Administration, Dartmouth College.

Mr. Child has served as a director of the Company since December 1987. Mr. Child is a partner of TA Associates, a venture capital firm, where he has been employed since July 1982. He is also a director of Cadence Design Systems, Inc., DH Technology, Inc., Samna Corporation and Novellus Systems, Inc. Mr. Child holds a BS in Electrical Engineering from the University of California, Davis, and an MBA from Stanford Graduate School of Business.

All directors hold office until the next annual meeting of stockholders or the election and qualification of their successors. Directors currently receive no compensation for serving on the Board. After the offering, the Company plans to seek an additional independent director. The Board of

Directors elects officers annually and such officers serve at the discretion of the Board. There are no family relationships among directors or officers of the Company.

Pursuant to a Shareholders Agreement dated December 31, 1987, all of the holders of the Company's Common Stock agreed to vote their shares so as to elect Drs. Saal and Shustek as members of the Board of Directors. This obligation terminates upon the closing of this offering. Under the Company's Certificate of Incorporation, as amended, the holders of the Series A Preferred Stock, voting separately as a class, have the right to elect one member of the Board of Directors, and the holders of the Common Stock have the right to elect the remaining directors. Mr. Child was elected a director by the holders of the Series A Preferred Stock pursuant to this provision of the Certificate. The rights of the holders of the Series A Preferred Stock to elect a director separately will terminate upon the conversion of such stock into Common Stock on the closing of this offering.

Limitation of Liability and Indemnification

Pursuant to provisions of the Delaware General Corporation Law, the Company has adopted provisions in its Certificate of Incorporation which eliminate the personal liability of its directors to the Company and its stockholders for monetary damages for breach of their duty of due care. With the approval of its Board and stockholders, the Company amended its Bylaws in December 1987 to require the Company to indemnify its directors, officers, employees and agents to the full extent permitted by the Delaware General Corporation Law, including those circumstances in which indemnification would otherwise be discretionary. The amended Bylaws expressly authorize the use of indemnity agreements, and, with the approval of its stockholders, the Company has entered into such agreements with each of its directors and executive officers.

Executive Officer Cash Compensation

The following table sets forth the cash compensation paid to each of the Company's executive officers whose cash compensation exceeded \$60,000 and all executive officers as a group for the fiscal year ended March 31, 1988:

<u>Name of Individual or Number in Group</u>	<u>Capacities in Which Served</u>	<u>Cash Compensation(1)</u>	
		<u>Base Salary</u>	<u>Bonus Plan</u>
Harry J. Saal	President and Chief Executive Officer	\$113,319	\$ 81,095
Leonard J. Shustek	Executive Vice President, Research and Development, and Secretary	88,333	61,095
George E. Comstock	Vice President, Marketing and Sales	168,452(2)	10,001
All executive officers as a group (4 persons) (3)		\$410,138	\$159,537

- (1) These figures include cash bonuses paid in fiscal 1989 for services rendered in fiscal 1988.
- (2) Includes \$140,327 in sales commissions paid to Mr. Comstock pursuant to his compensation arrangement with the Company.
- (3) Includes amounts paid to Roger C. Ferguson, who joined the Company as Vice President, Operations, and Chief Financial Officer in December 1987.

Cash Bonus Plan

In fiscal 1988, the Company initiated a bonus plan for officers and key employees which provided for payment of cash bonuses to the participants based upon the Company attaining certain revenue and operating profit goals and each participant's performance during the fiscal year. The Company's Board of Directors determines the amounts and recipients of the cash bonuses and establishes the specific goals upon which the awards are based. Approximately 15 persons participated in and received cash bonuses totaling approximately \$180,000 under the plan with respect to fiscal 1988. The

Company's directors who are not executive officers are not eligible to participate in the bonus plan. The Company has continued to accrue and pay bonuses under this plan in fiscal 1989.

Sales Commissions Arrangements

The Company has adopted arrangements with certain of its employees under which they have been paid, in addition to their regular salary and other regular employment benefits, compensation based on sales of the Company's products. Four people participated in sales incentive compensation arrangements in fiscal 1988, and the total amount of incentive compensation expensed was approximately \$204,000.

401(k) Plan

Effective September 15, 1988, the Company adopted a tax deferred savings plan (the "401(k) Plan") that covers all employees, other than those classified as temporary employees. Employees may contribute from 1% to 15% of their compensation to the 401(k) Plan on a pre-tax basis, not to exceed \$7,000 per year (adjusted for cost-of-living increases). Each quarter, the Company may match 25% of an employee's pre-tax contributions, up to a maximum of 6% of compensation. The rates of pre-tax and matching contributions may be reduced with respect to highly compensated employees, as defined in the Internal Revenue Code of 1986, as amended (the "Code"), so that the 401(k) Plan will comply with Sections 401(k) and 401(m) of the Code. Pre-tax and matching contributions are allocated to each employee's individual account, which is invested in selected mutual funds according to the directions of the employee. An employee's pre-tax contributions are fully vested and nonforfeitable at all times. Matching contributions vest ratably over three years of service. An employee may forfeit unvested amounts upon termination of employment, unless the termination is because of death, disability or retirement.

Stock Purchase Plan

On December 15, 1988, the Board of Directors adopted an employee stock purchase plan subject to stockholder approval (the "Stock Purchase Plan"). The Stock Purchase Plan will allow eligible employees to purchase Common Stock of the Company through payroll deductions. The Stock Purchase Plan is intended to qualify as an "employee stock purchase plan" under Section 423 of the Code. The Company has reserved 150,000 shares of its authorized but unissued Common Stock for issuance to eligible employees. Each offering of Common Stock under the Stock Purchase Plan will be for a period of six months. The first offering period is expected to begin on the date the offering contemplated by this Prospectus commences and end on June 30, 1989. The purchase price of shares acquired in any offering under the Stock Purchase Plan will be set by the Board of Directors; provided, however, that the purchase price will not be less than 85% of the lesser of (a) the fair market value of the shares on the first day of the offering period and (b) the fair market value of the shares on the last day of the offering period.

Stock Option Plan

The Company is considering establishing an employee stock option plan which would be qualified under Section 422A of the Code shortly after the closing of the offering contemplated by this Prospectus. The exercise price of shares subject to any option granted under the proposed plan would not be less than 85% of the fair market value of the shares on the date of grant. The specific terms of the plan would be subject to the approval of the Company's Board of Directors and stockholders, but the Company expects that approximately 250,000 shares of its Common Stock would be authorized for issuance under the proposed plan.

CERTAIN TRANSACTIONS

Stock Transactions

Unless indicated otherwise, the information regarding the prices and numbers of shares set forth below have been adjusted to account for the 300-for-1 exchange of shares pursuant to the merger of the Company's California predecessor into the Company effective December 3, 1987. On the closing date of this offering, each share of outstanding Series A Preferred Stock will convert into one share of Common Stock.

Harry J. Saal and Leonard J. Shustek may be considered to be "founders" of the Company within the meaning of the rules and regulations under the Securities Act of 1933, as amended (the "Act"). In May 1986, Drs. Saal and Shustek each purchased 1,500,000 shares of the Company's Common Stock at a price per share of \$.0033.

In a private financing held in December 1987, the Company sold an aggregate of 1,092,829 shares of Series A Preferred Stock at \$1.83 per share to seven sophisticated investors, including 928,161 shares to five entities affiliated with TA Associates, a venture capital firm (the "TA Associates Group"). Michael C. Child, a director of the Company, is a partner of TA Associates, which either controls or serves as the general partner of each of the entities in the TA Associates Group. Accordingly, Mr. Child may be deemed to share voting and investment power with respect to the shares held by the TA Associates Group.

Other Transactions

In May 1986, Drs. Saal and Shustek each made loans to the Company in the principal amount of \$10,000. The Company repaid both loans, with interest, in June 1987.

In June 1986, the Company entered into a master agreement to lease computer and office equipment from S&S Leasing Partnership, a company that is wholly owned by Drs. Saal and Shustek ("S&S"). The Company believes that the terms of its leasing arrangements with S&S are no less favorable than could have been obtained from unaffiliated parties. In fiscal 1987 and 1988 and the first nine months of fiscal 1989, the Company made lease payments of approximately \$27,875, \$107,075 and \$101,562, respectively, to S&S. The equipment leases entered into pursuant to the master agreement, as amended, were renewed in December 1988 and will expire in January 1990. The Company does not intend to lease any additional equipment from S&S beyond the items currently subject to leases and may use a portion of the net proceeds of the offering to purchase all equipment currently under lease at fair market value thus terminating the lease agreement. See "Use of Proceeds."

The Company has entered into indemnity agreements with each of its directors and executive officers. Those agreements require the Company to indemnify such individuals to the full extent permitted by the Delaware General Corporation Law. See "Management — Limitation of Liability and Indemnification."

The Company will not extend or guarantee loans to officers, directors, employees or affiliates of the Company unless such loans are approved by a majority of the directors and a majority of the disinterested, independent, outside directors of the Company, may reasonably be expected to benefit the Company and are for bona fide business purposes. In addition, all transactions between the Company and its officers, directors, principal stockholders or affiliates have been and will be on terms no less favorable to the Company than could be obtained from unaffiliated parties. All such future transactions will be approved by a majority of the Company's directors and a majority of the disinterested outside directors.

PRINCIPAL AND SELLING STOCKHOLDERS

The following table sets forth certain information regarding beneficial ownership of the Company's Common Stock as of December 31, 1988 (after giving effect to the automatic conversion of all outstanding Preferred Stock on the closing of this offering) and as adjusted to reflect the sale of the shares offered by this Prospectus by (i) each person who is known by the Company to own beneficially more than 5% of the Company's Common Stock, (ii) each of the Company's directors, (iii) all directors and executive officers as a group and (iv) each Selling Stockholder.

Beneficial Owner	Shares Beneficially Owned Prior to Offering (1)		Number of Shares Offered	Shares Beneficially Owned After Offering (1) (2)	
	Number	Percent		Number	Percent
Harry J. Saal(3) Network General Corporation 1945A Charleston Road Mountain View, CA 94043	1,500,000	30.9%	225,000	1,275,000	21.6%
Leonard J. Shustek Network General Corporation 1945A Charleston Road Mountain View, CA 94043	1,500,000	30.9%	225,000	1,275,000	21.6%
TA Associates Group(4) 45 Milk Street Boston, MA 02109	928,161	19.1%	233,563	694,598	11.7%
George E. Comstock Network General Corporation 1945A Charleston Road Mountain View, CA 94043	330,000	6.8%	47,000	283,000	4.8%
Irwin Roth 135 E. 36th Street New York, NY 10016	249,000	5.1%	40,000	209,000	3.5%
Roger C. Ferguson(5)	175,000	3.6%	20,000	155,000	2.6%
Chestnut III Limited Partnership	107,392	2.2%	27,024	80,368	1.4%
DESIFTA LIMITED	57,276	1.2%	14,413	42,863	*
Michael C. Child(6)	928,161	19.1%	233,563	694,598	11.7%
All officers and directors as a group (5 persons) (3) (5) (6)	4,433,161	91.5%	750,563	3,682,598	62.3%

* Less than one percent.

- (1) Except as indicated in the footnotes to this table, the persons named in the table have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them, subject to community property laws where applicable.
- (2) Assuming no exercise of the Underwriters' over-allotment option to purchase up to 285,000 shares from the Company. See "Underwriting."
- (3) Includes 67,794 shares held by Mr. Saal's children. Mr. Saal disclaims beneficial ownership of such shares.
- (4) Includes shares held by the following entities: Advent V Limited Partnership (447,931); Advent Atlantic and Pacific Limited Partnership (293,096); Chestnut Capital International II (110,076); Advent Industrial Limited Partnership (71,594); and TA Investors (5,464); which are selling 112,718 shares, 73,755 shares, 27,700 shares, 18,015 shares and 1,375 shares, respectively. Mr. Child, a director of the Company, is a partner of TA Associates, which either controls or serves as the general partner of each of the five entities in the TA Associates Group. See footnote 6 below.
- (5) Includes 116,667 shares which are subject to a repurchase option of the Company which lapses over time.
- (6) Includes the same shares as indicated to be held by the TA Associates Group. See footnote 4 above. Mr. Child disclaims beneficial ownership of all but 2,459 of the shares held by the TA Associates Group.

DESCRIPTION OF CAPITAL STOCK

The authorized capital stock of the Company consists of 10,000,000 shares of Common Stock, par value \$.01 per share, and 1,907,171 shares of Preferred Stock, par value \$.01 per share, after giving effect to the conversion of all outstanding Preferred Stock into Common Stock upon the closing of this offering.

Common Stock

As of December 31, 1988, there were 4,846,829 shares of Common Stock outstanding held of record by 12 stockholders (assuming conversion of all outstanding shares of Preferred Stock). There will be 5,914,829 shares of Common Stock outstanding (assuming the Underwriters' over-allotment option is not exercised) after giving effect to the sale of the shares of Common Stock offered hereby.

Subject to preferences that may be applicable to any outstanding Preferred Stock, holders of Common Stock are entitled to receive ratably such dividends as may be declared by the Board of Directors out of funds legally available therefor. See "Dividend Policy." Each holder of Common Stock is entitled to one vote for each share held of record by him or her. In the event of a liquidation, dissolution or winding up of the Company, holders of Common Stock are entitled to share ratably in all assets remaining after payment of liabilities and the liquidation preference of any outstanding Preferred Stock. Holders of Common Stock have no preemptive rights and have no rights to convert their Common Stock into any other securities and there are no redemption provisions with respect to such shares. All of the outstanding shares of Common Stock are fully paid and non-assessable.

Preferred Stock

As of December 31, 1988, there were outstanding 1,092,829 shares of Series A Preferred Stock, par value \$.01 per share. Upon the closing of this offering, each outstanding share of Series A Preferred Stock will convert automatically into one share of Common Stock. The Series A Preferred Stock so converted will be cancelled and may not be reissued. The Company will then have an authorized class of Preferred Stock consisting of 1,907,171 shares. The Preferred Stock may be issued from time to time in one or more series. The Company's Board of Directors has authority to provide for the issuance of the shares of Preferred Stock in series, to establish from time to time the number of shares to be included in each such series and to fix the designation, powers, preferences and rights of the shares of each such series and the qualifications, limitations or restrictions thereof, without any further vote or action by the stockholders. The issuance of Preferred Stock could decrease the amount of earnings and assets available for distribution to holders of Common Stock or adversely affect the rights and powers, including voting rights, of the holders of the Common Stock, and may have the effect of delaying, deferring or preventing a change in control of the Company. The Company has no present plans to issue any shares of Preferred Stock.

Transfer Agent and Registrar

The transfer agent and registrar for the Company's Common Stock will be Bank of America N.T. & S.A.

SHARES ELIGIBLE FOR FUTURE SALE

Upon completion of this offering, the Company will have approximately 5,914,829 shares of Common Stock outstanding (assuming no exercise of the Underwriters' over-allotment option). Of these shares, the 1,900,000 shares sold in this offering will be freely transferable without restriction or further registration under the Act, except for any shares purchased by an existing "affiliate" of the Company, as that term is defined by the Act (an "Affiliate"), which shares will be subject to the resale limitations of Rule 144 adopted under the Act. Beginning 90 days after the date of this Prospectus, and without consideration of the contractual restrictions described below, approximately 4,014,829

“restricted shares” as defined in Rule 144 will be outstanding, of which 2,550,000 shares will be eligible for sale in the public market under Rule 144. The remaining 1,464,829 restricted shares will not be transferable pursuant to Rule 144 or otherwise until the expiration of their respective two year holding periods, which will expire between August and December 1989.

Despite the potential availability of sales under Rule 144, each of the Company’s current stockholders has agreed not to offer, sell, contract to sell or grant any option to purchase or otherwise dispose of any shares of Common Stock of the Company owned by them for a period of 240 days after the date of this Prospectus without the prior written consent of the Representatives of the Underwriters. The Company has also agreed not to offer, sell, contract to sell or otherwise dispose of any shares of Common Stock or any securities convertible into or exercisable or exchangeable for Common Stock or any rights to acquire Common Stock for a period of 240 days after the date of this Prospectus without the prior written consent of the Representatives of the Underwriters, subject to certain limited exceptions.

In general, under Rule 144 as currently in effect, beginning 90 days after the offering, any person (or persons whose shares are aggregated) who has beneficially owned shares for at least two years is entitled to sell, within any three-month period, a number of shares that does not exceed the greater of 1% of the then outstanding shares of the Company’s Common Stock (approximately 59,148 shares immediately after the offering) or the average weekly trading volume of the Company’s Common Stock in the over-the-counter market during the four calendar weeks preceding the date on which notice of the sale is filed with the Securities and Exchange Commission. Sales under Rule 144 are also subject to certain manner of sale provisions, notice requirements and the availability of current public information about the Company. Any person (or persons whose shares are aggregated) who is not deemed to have been an Affiliate of the Company at any time during the three months preceding a sale, and who has beneficially owned shares within the definition of “restricted securities” under Rule 144 under the Act for at least three years, is entitled to sell such shares under Rule 144(k) without regard to the volume limitations, manner of sale provisions, public information requirements or notice requirements.

Registration Rights

The holders of the 1,092,829 shares of Common Stock that will be acquired upon the automatic conversion of the previously issued shares of Series A Preferred Stock upon the closing of this offering (the “Converted Shares”) are entitled to request that the Company file a registration statement under the Act covering the sale of some or all of the shares owned by such holders, subject to certain conditions. The Company is required to effect no more than one such registration. In addition, in the event the Company proposes to register any of its shares of Common Stock under the Act, including the offering contemplated by this Prospectus, the holders of the Converted Shares, Drs. Saal and Shustek, who together hold a total of 3,000,000 shares of Common Stock, and other employees of the Company designated by the Board of Directors are entitled to require the Company to include all or a portion of their shares in such registration, subject to certain conditions. All fees, costs, and expenses of such registrations will be borne by the Company, provided that such holders will be required to bear their pro rata share of the underwriting discounts and commissions. The Company will pay the fees, costs, and expenses of registering the shares to be sold in this offering, including the shares to be sold by the Selling Stockholders pursuant to either (i) the terms of a registration rights agreement with the Company or (ii) the previously obtained unanimous stockholder approval.

UNDERWRITING

Subject to the terms and conditions of the Underwriting Agreement, the Underwriters named below, through their Representatives, Alex. Brown & Sons Incorporated and Hambrecht & Quist Incorporated, have agreed, severally, to purchase from the Company and the Selling Stockholders the following respective number of shares of Common Stock of the Company at the initial offering price less the underwriting discounts and commissions set forth on the cover page of this Prospectus.

<u>Underwriter</u>	<u>Number of Shares</u>
Alex. Brown & Sons Incorporated	349,500
Hambrecht & Quist Incorporated	349,500
Bear, Stearns & Co. Inc.	35,000
The First Boston Corporation.....	35,000
Dillon Read & Co. Inc.	35,000
Drexel Burnham Lambert Incorporated	35,000
Kidder, Peabody & Co. Incorporated	35,000
Lazard Frères & Co.	35,000
Montgomery Securities	35,000
Morgan Stanley & Co. Incorporated	35,000
PaineWebber Incorporated	35,000
Prudential-Bache Securities Inc.	35,000
Robertson, Colman & Stephens	35,000
Salomon Brothers Inc	35,000
Shearson Lehman Hutton Inc.	35,000
Smith Barney, Harris Upham & Co. Incorporated	35,000
Wertheim Schroder & Co. Incorporated	35,000
William Blair & Company	25,000
Dain Bosworth Incorporated	25,000
A.G. Edwards & Sons, Inc.	25,000
Oppenheimer & Co., Inc.	25,000
Piper, Jaffray & Hopwood Incorporated	25,000
The Robinson-Humphrey Company, Inc.....	25,000
Thomson McKinnon Securities Inc.	25,000
Wheat, First Securities Inc.....	25,000
Advest, Inc.....	14,000
Arnhold and S. Bleichroeder, Inc.	14,000
Robert W. Baird & Co. Incorporated	14,000
Bateman Eichler, Hill Richards Incorporated	14,000
Sanford C. Bernstein & Co., Inc.	14,000
Blunt Ellis & Loewi Incorporated	14,000
Butcher & Singer Inc.	14,000
Cazenove Incorporated	14,000
The Chicago Corporation	14,000
Cowen & Co.	14,000
R.G. Dickinson & Co.....	14,000
First Albany Corporation.....	14,000
First Analysis Securities Corporation	14,000
Robert Fleming Inc.	14,000
Furman Selz Mager Dietz & Birney Incorporated	14,000
Interstate/Johnson Lane	14,000
Janney Montgomery Scott Inc.....	14,000
Johnston, Lemon & Co. Incorporated	14,000
Kleinwort, Benson Incorporated	14,000

<u>Underwriter</u>	<u>Number of Shares</u>
Ladenburg, Thalmann & Co., Inc.	14,000
C.J. Lawrence, Morgan Grenfell Inc.	14,000
Legg Mason Wood Walker, Incorporated	14,000
Mabon, Nugent & Co.	14,000
McDonald & Company Securities, Inc.	14,000
Needham & Company, Inc.	14,000
Prescott, Ball & Turben, Inc.	14,000
Ragen Mackenzie Incorporated	14,000
Raymond, James & Associates, Inc.	14,000
Stephens Inc.	14,000
Sutro & Co. Incorporated	14,000
Tucker, Anthony & R.L. Day, Inc.	14,000
Stifel, Nicolaus & Company, Incorporated	14,000
Van Kasper & Company	14,000
Volpe & Covington	14,000
Total	<u>1,900,000</u>

The Underwriting Agreement provides that the obligations of the Underwriters are subject to certain conditions precedent and that the Underwriters will purchase all shares of the Common Stock offered hereby if any such shares are to be purchased.

The Company and the Selling Stockholders have been advised by the Representatives of the Underwriters that the Underwriters propose to offer the shares of Common Stock to the public at the initial offering price set forth on the cover of this Prospectus and to certain dealers at such price less a concession of not in excess of \$.32 per share. The Underwriters may allow, and such dealers may realow, a concession of not in excess of \$.10 to other dealers. After the initial public offering, the offering price and other selling terms may be changed by the Representatives of the Underwriters.

The Company has granted to the Underwriters an option, exercisable not later than 30 days after the date of this Prospectus, to purchase up to 285,000 additional shares of Common Stock at the public offering price less the underwriting discounts and commissions set forth on the cover page of this Prospectus. To the extent that the Underwriters exercise such option, each of the Underwriters will have a firm commitment to purchase approximately the same percentage thereof that the number of shares of Common Stock to be purchased by it shown in the above table represents of the total shown, and the Company will be obligated, pursuant to the option, to cover over-allotments made in connection with the sale of shares of Common Stock offered hereby. If purchased, the Underwriters will sell such additional shares on the same terms as those on which the 1,900,000 shares are being offered.

The Underwriting Agreement contains covenants of indemnity among the Underwriters, the Company and the Selling Stockholders against certain civil liabilities, including liabilities under the Act.

The Representatives of the Underwriters have informed the Company that the Underwriters do not intend to confirm sales to any account over which they exercise discretionary authority.

All of the stockholders of the Company, holding approximately 4,846,829 shares of Common Stock in the aggregate, have agreed that they will not, without the prior written consent of the Representatives of the Underwriters, offer, sell or otherwise dispose of any shares of the Company's capital stock owned by them upon the completion of this offering for a period of 240 days from the date of this Prospectus.

Prior to the offering, there has been no public market for the Common Stock of the Company. Consequently, the offering price has been determined by negotiations among the Company and the Selling Stockholders and the Representatives of the Underwriters. Among the factors considered in such negotiations were the prevailing market conditions, the price-earnings ratios of publicly traded companies that the Company and Representatives of the Underwriters believed to be somewhat comparable to the Company, the sales and earnings of the Company in recent periods, estimates of the business potential of the Company, the present state of the Company's development and other factors deemed relevant.

LEGAL MATTERS

The validity of the shares offered hereby will be passed upon for the Company and the Selling Stockholders by Ware & Freidenrich, A Professional Corporation, Palo Alto, California. Certain legal matters will be passed upon for the Underwriters by Wilson, Sonsini, Goodrich & Rosati, Professional Corporation, Palo Alto, California.

EXPERTS

The consolidated financial statements, schedules and selected financial data included in this Prospectus and elsewhere in the Registration Statement to the extent and for the periods indicated in their reports have been audited by Arthur Andersen & Co., independent public accountants, as indicated in their reports with respect thereto, and are included herein in reliance upon the authority of said firm as experts in giving said reports.

ADDITIONAL INFORMATION

The Company has filed with the Securities and Exchange Commission, Washington, D.C. 20549, a Registration Statement on Form S-1 under the Securities Act of 1933, as amended, with respect to the Common Stock offered hereby. This Prospectus does not contain all of the information set forth in the Registration Statement and the exhibits and the schedules thereto. For further information with respect to the Company and such Common Stock, reference is made to the Registration Statement and exhibits and schedules thereto. Statements contained in this Prospectus as to the contents of any contract or any other document referred to are not necessarily complete, and, with respect to any contract or other document filed as an exhibit to the Registration Statement, each such statement is qualified in all respects by reference to such exhibit. The Registration Statement, including exhibits thereto, may be inspected without charge at the Commission's principal office in Washington, D.C., and copies of all or any part thereof may be obtained from such office after payment of fees prescribed by the Commission.

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Network General Corporation:

We have audited the accompanying consolidated balance sheets of Network General Corporation (a Delaware corporation) and subsidiary as of March 31, 1987, March 31, 1988, and September 30, 1988, and the related consolidated statements of operations, stockholders' equity and cash flows for the period from inception (May 15, 1986) to March 31, 1987, for the year ended March 31, 1988 and for the six months ended September 30, 1988. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Network General Corporation and subsidiary as of March 31, 1987, March 31, 1988, and September 30, 1988, and the results of their operations and their cash flows for the periods then ended in conformity with generally accepted accounting principles.

Also, in our opinion, the information set forth in the selected consolidated financial data for the period from inception (May 15, 1986) to March 31, 1987, the year ended March 31, 1988 and the six months ended September 30, 1988 appearing on page 9 of this Prospectus is fairly stated in all material respects in relation to the financial statements from which it has been derived.

ARTHUR ANDERSEN & CO.

San Jose, California
November 22, 1988

NETWORK GENERAL CORPORATION

CONSOLIDATED BALANCE SHEETS

ASSETS

	March 31,		September 30,
	1987	1988	1988
Current Assets:			
Cash and cash equivalents.....	\$ 47,367	\$1,378,542	\$ 808,408
Cash investments.....	—	1,500,000	1,500,000
Accounts receivable, net of allowance for doubtful accounts of \$37,500 at March 31, 1988 and \$60,000 at September 30, 1988.....	212,213	1,037,372	1,942,836
Inventories.....	19,895	223,185	629,460
Prepaid expenses and deposits.....	200	14,080	28,990
Prepaid taxes and deferred tax assets.....	—	119,731	210,227
Total current assets.....	<u>279,675</u>	<u>4,272,910</u>	<u>5,119,921</u>
Property and Equipment, at cost:			
Demonstration and rental equipment.....	39,622	257,923	417,190
Office and development equipment.....	4,240	21,723	59,756
Less—Accumulated depreciation.....	<u>(4,618)</u>	<u>(59,034)</u>	<u>(210,086)</u>
	39,244	220,612	266,860
Other Assets.....	<u>22,243</u>	<u>19,972</u>	<u>16,764</u>
	<u>\$341,162</u>	<u>\$4,513,494</u>	<u>\$5,403,545</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:			
Accounts payable.....	\$ 72,162	\$ 286,368	\$ 484,412
Accrued liabilities.....	213,870	538,787	780,468
Notes payable to officers.....	20,000	—	—
Income taxes payable.....	—	736,505	—
Customer deposits.....	—	48,055	66,854
Total current liabilities.....	<u>306,032</u>	<u>1,609,715</u>	<u>1,331,734</u>
Long-Term Customer Deposits.....	<u>25,000</u>	<u>75,000</u>	<u>82,500</u>
Series A Mandatorily Redeemable Convertible Preferred Stock—\$.01 par value, preference in liquidation of \$1,999,877			
Designated and outstanding—1,092,829 shares in 1988	—	1,967,657	1,967,657
Stockholders' Equity:			
Common stock—\$.01 par value			
Authorized—10,000,000 shares			
Outstanding—3,579,000 shares in 1987 and 3,754,000 shares in 1988.....	11,930	37,540	37,540
Additional paid-in capital.....	—	15,750	15,750
Less—Notes receivable from sale of stock.....	(1,930)	—	—
Retained earnings.....	<u>130</u>	<u>807,832</u>	<u>1,968,364</u>
Total stockholders' equity.....	<u>10,130</u>	<u>861,122</u>	<u>2,021,654</u>
	<u>\$341,162</u>	<u>\$4,513,494</u>	<u>\$5,403,545</u>

The accompanying notes are an integral part of these consolidated balance sheets.

NETWORK GENERAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Inception (May 15, 1986) to March 31, 1987	Year Ended March 31, 1988	Six Months Ended September 30, 1987 (Unaudited)	1988
Revenues	\$ 555,622	\$4,911,387	\$1,571,946	\$5,473,375
Cost of Revenues	<u>159,779</u>	<u>1,128,754</u>	<u>347,294</u>	<u>1,163,826</u>
Gross profit	<u>395,843</u>	<u>3,782,633</u>	<u>1,224,652</u>	<u>4,309,549</u>
Operating Expenses:				
Marketing and sales	65,643	1,302,174	354,400	1,676,077
Research and development	158,000	364,700	189,041	383,442
General and administrative	<u>169,870</u>	<u>688,865</u>	<u>276,967</u>	<u>393,349</u>
	<u>393,513</u>	<u>2,355,739</u>	<u>820,408</u>	<u>2,452,868</u>
Income from operations	2,330	1,426,894	404,244	1,856,681
Interest Income (Expense), net	<u>(2,200)</u>	<u>32,968</u>	<u>2,555</u>	<u>75,851</u>
Income before provision for income taxes	130	1,459,862	406,799	1,932,532
Provision for Income Taxes	<u>—</u>	<u>628,300</u>	<u>175,086</u>	<u>772,000</u>
Net income	<u>\$ 130</u>	<u>\$ 831,562</u>	<u>\$ 231,713</u>	<u>\$1,160,532</u>
Earnings Per Share	<u>\$—</u>	<u>\$.21</u>	<u>\$.06</u>	<u>\$.24</u>
Weighted Average Shares Outstanding	<u>3,276,000</u>	<u>3,903,000</u>	<u>3,579,000</u>	<u>4,847,000</u>

The accompanying notes are an integral part of these consolidated financial statements.

NETWORK GENERAL CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Notes Receivable from Sale of Stock</u>	<u>Retained Earnings</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
Sale of common stock at \$.0033 per share to founders . . .	3,000,000	\$10,000	\$ —	\$ —	\$ —	\$ 10,000
Issuance of common stock at \$.0033 per share in exchange for notes receivable	579,000	1,930	—	(1,930)	—	—
Net income	—	—	—	—	130	130
Balance, March 31, 1987	3,579,000	11,930	—	(1,930)	130	10,130
Change in par value to \$.01 per share upon reincorporation from California to Delaware	—	23,860	—	—	(23,860)	—
Exercise of stock options at \$.10 per share	175,000	1,750	15,750	—	—	17,500
Collections on notes receivable from sale of stock	—	—	—	1,930	—	1,930
Net income	—	—	—	—	831,562	831,562
Balance, March 31, 1988	3,754,000	37,540	15,750	—	807,832	861,122
Net income	—	—	—	—	1,160,532	1,160,532
Balance, September 30, 1988	<u>3,754,000</u>	<u>\$37,540</u>	<u>\$15,750</u>	<u>\$ —</u>	<u>\$1,968,364</u>	<u>\$2,021,654</u>

The accompanying notes are an integral part of these consolidated financial statements.

NETWORK GENERAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Inception (May 15, 1986) to March 31, 1987	Year Ended March 31, 1988	Six Months Ended September 30, 1987 (Unaudited)	1988
Cash Flows from Operating Activities:				
Net income	\$ 130	\$ 831,562	\$231,713	\$1,160,532
Adjustments to reconcile net income to net cash provided by operating activities—				
Depreciation and amortization	7,078	56,063	5,587	152,260
Provision for doubtful accounts	—	37,500	27,500	22,500
(Increase) decrease in assets—				
Accounts receivable	(212,213)	(862,659)	(320,438)	(927,964)
Inventories	(19,895)	(203,290)	(93,714)	(406,275)
Prepaid expense and deposits	(200)	(13,880)	(32,536)	(14,910)
Prepaid taxes and deferred tax assets	—	(119,731)	—	(90,496)
Other assets	(24,703)	624	8,759	2,000
Increase (decrease) in liabilities—				
Accounts payable and accrued liabilities	286,032	539,123	223,844	439,725
Income taxes payable	—	736,505	197,962	(736,505)
Net cash provided by (used in) operating activities	<u>36,229</u>	<u>1,001,817</u>	<u>248,677</u>	<u>(399,133)</u>
Cash Flows from Investing Activities:				
Proceeds from customer deposits against demonstra- tion and rental equipment	25,000	98,055	70,245	26,299
Purchase of property and equipment	(43,862)	(235,784)	(48,876)	(197,300)
Cash investments made	—	(1,500,000)	—	—
Net cash provided by (used in) investing activities	<u>(18,862)</u>	<u>(1,637,729)</u>	<u>21,369</u>	<u>(171,001)</u>
Cash Flows from Financing Activities:				
Proceeds from issuance of preferred stock	—	1,967,657	—	—
Proceeds from issuance of common stock	10,000	17,500	—	—
Proceeds from (repayment of) notes payable to officers	20,000	(20,000)	(20,000)	—
Collection on notes receivable from sale of stock ...	—	1,930	1,930	—
Net cash provided by (used in) financing activities	<u>30,000</u>	<u>1,967,087</u>	<u>(18,070)</u>	<u>—</u>
Net increase (decrease) in cash and cash equivalents	47,367	1,331,175	251,976	(570,134)
Cash and Cash Equivalents at Beginning of Period	—	47,367	47,367	1,378,542
Cash and Cash Equivalents at End of Period	<u>\$ 47,367</u>	<u>\$1,378,542</u>	<u>\$299,343</u>	<u>\$ 808,408</u>

The accompanying notes are an integral part of these consolidated financial statements.

NETWORK GENERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 1988

(1) OPERATIONS:

Network General Corporation ("the Company") designs, markets and supports software-based LAN analysis tools for a broad spectrum of physical connection technologies and communications protocols. The Company was incorporated in 1986 as a California corporation and changed its state of incorporation to Delaware in fiscal 1988.

See "Risk Factors" included elsewhere in this Prospectus for a discussion of certain factors impacting the Company's operations.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, after elimination of intercompany accounts and transactions.

Revenues

The Company generally recognizes revenues upon shipment of the systems or software. Revenues on rental units are recognized ratably over the term of the rental period. Royalty income is recognized based on the number of copies of software sold by the licensees of the software products in the prior month. Revenues on software development contracts with certain OEM customers are recognized based on milestones specified in the contracts. Total revenues from rental units, royalties and software development contracts approximated \$36,000, \$230,000 and \$400,000 for fiscal 1987, 1988 and the six months ended September 30, 1988, respectively. One customer accounted for 11% of total fiscal 1987 revenues. No single customer accounted for more than 10% of revenues for fiscal 1988 or the six-month period ended September 30, 1988. Export sales, mainly to Europe and Japan, accounted for 22% of revenues in 1988 and 10% of revenues for the six-month period ended September 30, 1988. There were no export sales in 1987.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Company considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. Cash investments consist of certificates of deposit with maturities of greater than three months.

The Company paid approximately \$12,000 and \$1,597,000 in income taxes in fiscal 1988 and in the six-month period ended September 30, 1988, respectively. (See Note 10) Amounts paid for interest were insignificant.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and include material, labor and related manufacturing overhead. Inventories consist of:

	March 31,		September 30,
	1987	1988	1988
Purchased parts	\$ 13,782	\$101,535	\$427,078
Work-in-process	1,306	121,650	197,797
Finished goods	4,807	—	4,585
	<u>\$ 19,895</u>	<u>\$223,185</u>	<u>\$629,460</u>

NETWORK GENERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

September 30, 1988

Property and Equipment

Property and equipment are depreciated using the straight-line method over the following estimated useful lives:

<u>Classification</u>	<u>Life</u>
Demonstration and rental equipment	1-2 years
Office and development equipment	3 years

In general, the Company requires the manufacturer's representative or customer to pay a refundable deposit against each demonstration or rental unit that is delivered. A certain percentage of rental payments can be applied towards the purchase of the unit.

Software Development Costs

The Company anticipates capitalizing eligible computer software development costs upon the establishment of technological feasibility, which the Company has defined as completion of a working model. As of September 30, 1988, such capitalizable costs were insignificant and, thus, the Company has charged all software development costs to expense in the accompanying statements of operations.

Earnings Per Share

Earnings per share is computed using the weighted average number of shares of common and convertible preferred stock outstanding during the periods. Fully diluted earnings per share is the same as primary earnings per share.

(3) ACCRUED LIABILITIES:

Accrued liabilities consist of the following:

	<u>March 31,</u>		<u>September 30,</u>
	<u>1987</u>	<u>1988</u>	<u>1988</u>
Accrued compensation and related taxes ...	\$120,415	\$196,607	\$241,484
Accrued commissions	23,439	227,721	379,294
Other accrued expenses	70,016	114,459	159,690
	<u>\$213,870</u>	<u>\$538,787</u>	<u>\$780,468</u>

(4) NOTES PAYABLE TO OFFICERS:

The Company had outstanding notes payable of \$20,000 at March 31, 1987 which were due to two officers of the Company. The notes were unsecured, accrued interest at 12%, and were repaid in full in June 1987. The related interest expense of approximately \$2,400 was charged to operations in the accompanying consolidated statements of operations.

NETWORK GENERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

September 30, 1988

(5) COMMITMENTS:

The Company leases certain equipment under operating lease agreements with a company that is wholly owned by two officers and shareholders of the Company. Payments of \$27,875, \$107,075 and \$64,890 were paid to this leasing company in fiscal 1987, 1988 and in the first six months of fiscal 1989, respectively. Remaining minimum future lease payments under these lease agreements which were originally scheduled to expire on December 31, 1988 were \$34,500 as of September 30, 1988. The Company also leases its facilities and certain other equipment under operating lease agreements. At September 30, 1988, minimum future lease payments under all operating leases are as follows:

<u>Fiscal Year</u>	
1989 (six months)	\$120,300
1990	183,400
1991	71,000
1992	11,700
1993	11,600
1994	1,900
	<u>\$399,900</u>

Total rent expense was approximately \$63,000, \$127,000 and \$132,000 in fiscal 1987, 1988 and in the first six months of fiscal 1989, respectively.

(6) CASH BONUS:

In fiscal 1988, the Company established a discretionary cash bonus plan for its employees. The amounts and individuals to be awarded the bonus are based on the achievement of certain performance goals for the Company and the individual, as approved by the Board of Directors. The Company recorded bonus expense of approximately \$180,000 in fiscal 1988 and \$200,500 for the first six months of fiscal 1989.

(7) EMPLOYEE SAVINGS PLAN:

In September 1988, the Board of Directors approved an employee savings plan (the "Plan") which is intended to be qualified and exempt from tax under section 401(k) of the Internal Revenue Code. Under the Plan, employees may elect to contribute up to 15% of their gross compensation. The Company contributes to the Plan to the extent of the lesser of 25% of amounts contributed by participants or 6% of the gross compensation of the participants. All contributions by the Company are funded currently and vest ratably over three years. All employee contributions are fully vested. The Plan expense for the first six months of fiscal 1989 was approximately \$5,000.

(8) REDEEMABLE PREFERRED STOCK:

The Company has 3,000,000 authorized shares of preferred stock (par value \$.01 per share). In fiscal 1988, the Company issued 1,092,829 shares of preferred stock designated as Series A at \$1.83 per share for total proceeds, net of expenses of \$32,220, of \$1,967,657. Such shares have the following rights and privileges:

Conversion Rights—Each share of preferred stock is convertible, at the option of the holder, into one share of common stock adjusted for any stock dividends or splits. Each share of preferred stock automatically converts into one share of common stock upon the earlier of receiving consent

NETWORK GENERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) September 30, 1988

to convert from two-thirds of the outstanding Series A shareholders, or the closing of a public offering of the Company's common stock with proceeds of at least \$5,000,000 and a per share price of at least \$3.66. Additionally, the shareholders have certain registration rights.

The pro forma stockholders' equity of the Company reflecting the conversion of the preferred stock into common stock which will occur upon the closing of the proposed offering is as follows:

	September 30, 1988	
	<u>Historical</u>	<u>Pro Forma</u>
Series A mandatorily redeemable convertible preferred stock; \$.01 par value, preference in liquidation of \$1,999,877		
Designated and outstanding—1,092,829 shares	\$1,967,657	\$ —
Stockholders' equity:		
Preferred stock—\$.01 par value		
Authorized—1,907,171 shares (pro forma)		
Outstanding—none (pro forma)	\$ —	\$ —
Common stock—\$.01 par value		
Authorized—10,000,000 shares	37,540	48,468
Outstanding—3,754,000 shares (historical) and 4,846,829 shares (pro forma)		
Additional paid-in capital	15,750	1,972,479
Retained earnings	1,968,364	1,968,364
Total stockholders' equity	<u>\$2,021,654</u>	<u>\$3,989,311</u>

Liquidation Preference—In the event of liquidation, dissolution or winding up of the Company, the holders of Series A shares are entitled to a liquidation preference of \$1.83 per share plus all declared but unpaid dividends. If distributable assets are greater than \$5,000,000, then the \$1.83 per share liquidation preference will be further increased by a pre-defined formula based on the ratio of distributable assets to total shares outstanding.

Dividends—No dividends may be paid by the Company on any of its shares of capital stock without the prior approval of a majority of the Series A shareholders.

Redemption—Fifty percent of the Series A shares are mandatorily redeemable on December 31, 1993 and the remainder on December 31, 1994. The redemption price shall be \$1.83 per share plus any accrued but unpaid dividends.

Voting Rights—Each share of preferred stock has voting rights equal to the number of common shares into which it is convertible.

Other Rights—The Company shall obtain the approval of at least a majority of the total number of outstanding shares of Series A preferred stock before (i) changing any of the preferences, privileges or rights of the Series A shares, (ii) increasing the number of authorized shares of Series A preferred stock, (iii) undertaking a merger or sale of the Company where the value of the assets distributed is less than two and one-half times the purchase price of the Series A shares, or (iv) creating a new class of preferred shares.

NETWORK GENERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) **September 30, 1988**

(9) COMMON STOCK:

In connection with the reincorporation of the Company from California to Delaware, each previously outstanding share of common stock was converted into 300 common shares of the Delaware corporation. The accompanying financial statements have been retroactively restated to reflect this conversion.

As of September 30, 1988, 1,092,829 shares of common stock have been reserved for the future conversion of the Series A preferred shares into common stock.

(10) INCOME TAXES:

The Company has elected early implementation of the Statement of Financial Accounting Standards No. 96 "Accounting for Income Taxes" for fiscal 1988 and 1989 in these financial statements.

The components of the provision for income taxes for fiscal 1988 and the first six months of fiscal 1989 consisted of the following:

	<u>1988</u>	<u>Six Months Ended September 30, 1988</u>
Federal—		
Current payable	\$593,596	\$662,000
Deferred tax asset	(119,731)	(69,000)
	473,865	593,000
State—		
Current payable	154,435	179,000
	<u>\$628,300</u>	<u>\$772,000</u>

The sources of deferred tax assets were as follows:

	<u>1988</u>	<u>Six Months Ended September 30, 1988</u>
Reserves and accruals not currently deductible for tax purposes	\$ 51,100	\$15,000
State taxes, not currently deductible for tax purposes	57,140	36,000
Other	11,491	18,000
	<u>\$119,731</u>	<u>\$69,000</u>

NETWORK GENERAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) September 30, 1988

The following is a reconciliation of the effective income tax rate for financial statement purposes to the United States statutory Federal income tax rate for fiscal 1988 and the six months ended September 30, 1988:

	<u>1988</u>	<u>Six Months Ended September 30, 1988</u>
Statutory Federal income tax rate.....	37.0%	34.0%
State income taxes, net of Federal benefit	5.9	6.1
Other	<u>.1</u>	<u>(.2)</u>
	<u>43.0%</u>	<u>39.9%</u>

NETWORK GENERAL CORPORATION

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS (Unaudited)

The Condensed Consolidated Interim Financial Statements of Network General Corporation have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The Company believes the information included in the Condensed Consolidated Interim Financial Statements, when read in conjunction with the Financial Statements as of September 30, 1988 and the notes thereto included elsewhere herein, are adequate to make the information presented not misleading.

The Condensed Consolidated Interim Financial Statements reflect, in the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to summarize fairly the financial position, results of operations and cash flows for such periods.

The results of operations for the three and nine month periods ended December 31, 1988 are not necessarily indicative of the results that may be expected for the entire fiscal year ending March 31, 1989.

NETWORK GENERAL CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

ASSETS

	December 31, 1988
Current Assets:	
Cash and cash equivalents	\$ 237,198
Cash investments	2,184,841
Accounts receivable, net	2,151,928
Inventories	579,229
Prepaid expenses and deposits	86,420
Prepaid taxes and deferred tax assets	244,227
Total current assets	<u>5,483,843</u>
Property and Equipment, at cost:	
Demonstration and rental equipment	638,118
Office and development equipment	116,260
Less—Accumulated depreciation	<u>(223,931)</u>
	530,447
Other Assets	16,159
	<u><u>\$6,030,449</u></u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:	
Accounts payable	\$ 219,040
Accrued liabilities	829,100
Income taxes payable	215,000
Customer deposits	75,306
Total current liabilities	<u>1,338,446</u>
Long-Term Customer Deposits	<u>84,000</u>
Series A Mandatorily Redeemable Convertible Preferred Stock—	
\$.01 par value, preference in liquidation of \$1,999,877	
Designated and outstanding—1,092,829 shares	<u>1,967,657</u>
Stockholders' Equity:	
Common stock—\$.01 par value	
Authorized—10,000,000 shares	
Outstanding—3,754,000	37,540
Additional paid-in capital	15,750
Retained earnings	<u>2,587,056</u>
Total stockholders' equity	<u>2,640,346</u>
	<u><u>\$6,030,449</u></u>

The accompanying notes to condensed consolidated interim financial statements
are an integral part of this consolidated balance sheet.

NETWORK GENERAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	1987	1988	1987	1988
Revenues	\$1,622,286	\$3,380,867	\$3,194,232	\$8,854,242
Cost of Revenues	<u>383,002</u>	<u>874,851</u>	<u>730,296</u>	<u>2,038,677</u>
Gross profit	<u>1,239,284</u>	<u>2,506,016</u>	<u>2,463,936</u>	<u>6,815,565</u>
Operating Expenses:				
Marketing and sales	429,652	1,032,639	784,052	2,708,716
Research and development	78,796	247,325	267,837	630,767
General and administrative	<u>210,185</u>	<u>230,731</u>	<u>487,152</u>	<u>624,080</u>
	<u>718,633</u>	<u>1,510,695</u>	<u>1,539,041</u>	<u>3,963,563</u>
Income from operations	520,651	995,321	924,895	2,852,002
Interest Income (Expense), net	<u>5,947</u>	<u>36,371</u>	<u>8,502</u>	<u>112,222</u>
Income before provision for income taxes	526,598	1,031,692	933,397	2,964,224
Provision for Income Taxes	<u>226,633</u>	<u>413,000</u>	<u>401,719</u>	<u>1,185,000</u>
Net income	<u>\$ 299,965</u>	<u>\$ 618,692</u>	<u>\$ 531,678</u>	<u>\$1,779,224</u>
Earnings Per Share	<u>\$.08</u>	<u>\$.13</u>	<u>\$.15</u>	<u>\$.37</u>
Weighted Average Shares Outstanding	<u>3,625,000</u>	<u>4,847,000</u>	<u>3,594,000</u>	<u>4,847,000</u>

The accompanying notes to condensed consolidated interim financial statements
are an integral part of these consolidated financial statements.

NETWORK GENERAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Nine Months Ended December 31,	
	<u>1987</u>	<u>1988</u>
Cash Flows from Operating Activities:		
Net income	\$ 531,678	\$ 1,779,224
Adjustments to reconcile net income to net cash provided by operating activities—		
Depreciation and amortization	12,907	223,721
Provision for doubtful accounts	37,500	22,500
(Increase) decrease in assets—		
Accounts receivable	(570,355)	(1,137,056)
Inventories	(118,680)	(356,044)
Prepaid expense and deposits	200	(72,340)
Prepaid taxes and deferred tax assets	(100,613)	(124,496)
Other assets	(2,087)	2,000
Increase (decrease) in liabilities—		
Accounts payable and accrued liabilities	574,799	222,985
Income taxes payable	470,992	(521,505)
Net cash provided by operating activities	<u>836,341</u>	<u>38,989</u>
Cash Flows from Investing Activities:		
Proceeds from customer deposits against demonstration and rental equipment	99,610	36,251
Purchase of property and equipment	(73,188)	(531,743)
Cash investments made	—	(684,841)
Net cash provided by (used in) investing activities	<u>26,422</u>	<u>(1,180,333)</u>
Cash Flows from Financing Activities:		
Proceeds from issuance of common stock	17,500	—
Repayment of notes payable to officers	(20,000)	—
Collection on notes receivable from sale of stock	1,930	—
Net cash used in financing activities	<u>(570)</u>	<u>—</u>
Net increase (decrease) in cash and cash equivalents	862,193	(1,141,344)
Cash and Cash Equivalents at Beginning of Period	47,367	1,378,542
Cash and Cash Equivalents at End of Period	<u>\$ 909,560</u>	<u>\$ 237,198</u>

The accompanying notes to condensed consolidated interim financial statements
are an integral part of these consolidated financial statements.

NETWORK GENERAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

A. INVENTORIES

Inventories as of December 31, 1988 were comprised of the following:

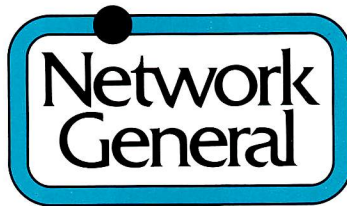
Raw materials.....	\$331,097
Work-in-process	74,202
Finished goods.....	<u>173,930</u>
Total.....	<u>\$579,229</u>

B. EARNINGS PER SHARE

Earnings per share has been computed using the weighting average number of common shares and convertible preferred shares outstanding during the periods.

C. COMMITMENTS

In December 1988, the Company extended the term of certain leases with a company that is wholly owned by two officers and shareholders of the Company. Remaining minimum future lease payments under these agreements as of December 31, 1988 were approximately \$143,500. Payments of approximately \$101,500 were paid to the leasing company in the first nine months of fiscal 1989.



**1,900,000 Shares
Common Stock**

PROSPECTUS

Alex. Brown & Sons
Incorporated

Hambrecht & Quist
Incorporated
